

## 2005 Annual Report to Congress: The Most Serious Problems Encountered By Taxpayers

### 2005 ARC – MSP

#### Topic #1 TRENDS IN TAXPAYER SERVICE

##### Problem

As the IRS proposes to allocate more resources to collection, examination, and criminal investigation functions and fewer resources to taxpayer service functions, the IRS is also increasing efforts to “migrate” taxpayers toward electronic services and away from face-to-face contact. Before altering the mix of service and enforcement, the National Taxpayer Advocate believes the IRS should spend more time studying what types of services different taxpayer segments need and how best to deliver these services to help taxpayers remain compliant. The National Taxpayer Advocate recommends that the IRS undertake a research-driven needs-assessment, from the taxpayers’ perspective, to help identify what services taxpayers need and want and how best to deliver them. An assessment of needs will also help identify groups of taxpayers that may be resistant to, or unable to access, certain services. Once the IRS conducts a detailed assessment and understands how any proposed changes to taxpayer service may affect compliance, the IRS should develop a detailed strategy for migrating taxpayers from the current to the proposed model of delivering taxpayer service.

##### NTA Recommendations

1. Engage in a detailed needs assessment, from the taxpayers’ perspective, as part of the IRS’ five-year plan for taxpayer service.
2. Identify all taxpayer services currently offered and all possible channels of communication for offering these services in order to determine which channels are most effective for delivering the services.
3. Develop an understanding of what taxpayers prefer, as well as whether taxpayer preferences can be changed and whether there are any limitations on the IRS’ ability to change those preferences.
4. Examine both internal and external research regarding taxpayer preferences.
5. Explore how any changes to taxpayer service will affect compliance.
6. Examine other state and federal agencies to determine whether anything can be learned from the ways in which they provide services.
7. Develop a strategy for implementing changes to the current taxpayer service structure, including a plan for migrating taxpayers to different communication channels.
8. Maintain the current level of taxpayer service until the IRS’ five-year plan for taxpayer service is completed.

##### NTA Recommendations 1, 2, 3, 4, 5, 6 and 7

1. Engage in a detailed needs assessment, from the taxpayers’ perspective, as part of the IRS’ five-year plan for taxpayer service.

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2. Identify all taxpayer services currently offered and all possible channels of communication for offering these services in order to determine which channels are most effective for delivering the services.
3. Develop an understanding of what taxpayers prefer, as well as whether taxpayer preferences can be changed and whether there are any limitations on the IRS' ability to change those preferences.
4. Examine both internal and external research regarding taxpayer preferences.
5. Explore how any changes to taxpayer service will affect compliance.
6. Examine other state and federal agencies to determine whether anything can be learned from the ways in which they provide services.
7. Develop a strategy for implementing changes to the current taxpayer service structure, including a plan for migrating taxpayers to different communication channels.

### IRS Response to Recommendations 1, 2, 3, 4, 5, 6 and 7

Over the last five years, the IRS has focused on improving service to individual taxpayers. The IRS Taxpayer Assistance Vision, W&I's Concept of Operations, our Strategic Plans, the "Service + Enforcement = Compliance" equation – all addressed a common theme of improved service. In September 2005, the Taxpayer Assistance Blueprint (TAB) Team was formed to address fundamental questions regarding today's IRS customer and their tax assistance needs from the customer point of view. While TAB builds upon several years of strategic planning efforts, it also addresses a recent Congressional directive to ascertain taxpayer needs and preferences and develop a five year plan to address them. The TAB's project objectives are:

- Develop a credible baseline by assessing current service offerings and delivery channels, and customer needs, behaviors, and preferences across various demographic segments.
- Develop long-term metrics by which the effectiveness of taxpayer assistance can be gauged.
- Develop a repeatable and reliable process that can be institutionalized and integrated into the IRS' existing strategic planning and budgeting processes to ensure the continuous evaluation of taxpayer assistance.
- Develop recommendations and plan for addressing gaps in customer needs and preferences, and evaluate innovative approaches to assistance that will be implemented over the next 2 – 5 years.
- Assess the impact of the recommendations on current and future planning, funding, and modernization processes.

The team has outlined the project scope in the context of current IRS business planning and customer service activities and will be using a two phase approach to address the Congressional directive. To comply with the Congressional directive, the TAB Phase I report, prepared by IRS, the IRS Oversight Board, and National Taxpayer Advocate, was submitted to Congress in April 2006. The Phase 2 report is targeted for completion in October 2006

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### TAB Phases 1 & 2

To determine customer needs, preferences, and demands, TAB Phase 1 included secondary research; surveys of third-party stakeholders, partners and employees; gap analysis; and blueprint design and development. In addition, current services offered, channels available, and other factors were delineated in Phase 1. The TAB team also conducted extensive interviews and reviewed existing research to identify and consider leading practices from the private sector, government agencies, and international and state tax administration organizations to develop improvement opportunities.

As a result of the efforts in Phase 1, the following five strategic improvement themes were developed:

- Improve and expand education and awareness activities
- Optimize the use of partner services
- Elevate self-service options to meet taxpayer expectations
- Improve and expand training and support tools to enhance assisted services
- Develop short-term performance and long-term outcome goals and metrics

TAB Phase 2, currently underway, builds on the strategic improvement themes and will produce a five-year plan for preferred service delivery to individual taxpayers within available resources. Phase 2 includes additional research; development of an implementation plan for recommendations; integration of recommendations into the budgeting process; and integration of the blueprint into the IRS Strategic Plan. Phase 2 research considerations will include what service changes may be needed and the impact of service on compliance.

To ensure key stakeholders are informed and engaged throughout the process, a comprehensive stakeholder engagement plan was developed and implemented. This plan is being executed to ensure input from customers, employees, and intermediaries that either serve or represent taxpayers and oversight bodies.

### **NTA Status Update to Recommendations 1, 2, 3, 4, 5, 6 and 7**

#### **NTA Recommendation 8**

Maintain the current level of taxpayer service until the IRS' five-year plan for taxpayer service is completed.

#### **IRS Response to Recommendation 8**

In virtually all key service areas high levels of performance and accuracy have been maintained or improved even while we are revitalizing our enforcement program. As important, we have continued to respect taxpayer rights as we have

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rebalanced our service and enforcement program. We are particularly proud that we have sustained these performance levels, notwithstanding the diversion of substantial resources, both human and technical, in order to answer almost one million telephone calls for FEMA as our employees rose to the challenge of assisting taxpayers impacted by this year's devastating hurricane season.

The IRS continually strives to balance service and compliance initiatives while attempting to meet the needs of a wide-ranging taxpayer population amid fiscal limitations. As an organization we are committed to providing the proper balance between these two complementary activities to ensure continued voluntary compliance and to address the tax gap as reported in NTA's Most Serious Problem – *The Cash Economy*.

It is important to recognize that the IRS has been able to obtain these significant improvements in taxpayer service through constantly striving to align more efficient and effective methods of providing services with the evolving needs and preferences of taxpayers. For example, the IRS has --

- Employed advanced call routing technology
- Developed interactive job aids for our employees
- Improved our information systems
- Strengthened our managerial and executive involvement in service delivery
- Analyzed the tax law changes to determine the impact on our service to walk-in, telephone, and tax assistance customers
- Expanded service to alternative locations, (such as post offices, federal and state offices, libraries, and community organizations) during the filing season through national and community-based partners
- Provided increased return preparation service and outreach
- Realigned support functions and expanded the use of technology to improve efficiency in pre-filing and outreach efforts

Aligning service delivery with the services taxpayers use most frequently lets the IRS meet taxpayers needs while spending their tax dollars more efficiently. Truly noteworthy are our gains in providing information and services via the internet. Each year has shown solid growth in the number of internet customers. This year IRS.gov continued to be one of the most visited websites in the world.

### **NTA Status Update to Recommendation 8**

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### 2005 ARC – MSP Topic #2 CRIMINAL INVESTIGATION REFUND FREEZES

#### Problem

The IRS Criminal Investigation function (CI), through its Questionable Refund Program (QRP), places a “freeze” on hundreds of thousands of refund claims each year that it believes may contain indicia of fraud. CI personnel currently review the refund claims and “determine” whether they are fraudulent – without notifying taxpayers that their claims are under review and without giving taxpayers an opportunity to present documentation supporting their positions. Last year, the Taxpayer Advocate Service (TAS) received more than 28,000 requests for assistance from taxpayers whose refunds had been frozen. TAS studied a randomly selected sample of nearly 500 cases to determine the ultimate disposition of these cases. When TAS assisted the taxpayers, CI ultimately agreed to issue the full amount of the refund claimed (or more) in 66 percent of the decided cases and to issue a partial refund in an additional 14 percent of the decided cases. Thus, taxpayers received a full or partial refund in 80 percent of frozen-refund cases brought to TAS. The median Adjusted Gross Income (AGI) of these taxpayers was \$13,330, and the median refund was \$3,519. Thus, the refund constituted, on average, more than 26 percent of the claimant’s AGI for the year, and the taxpayers were required to wait, on average, more than 8-1/2 months to receive their refunds. The National Taxpayer Advocate believes that the QRP is an important program to protect against tax fraud, but the IRS must implement procedures to notify taxpayers that their refunds have been frozen, provide taxpayers with an opportunity to submit documentation, and bring cases to a quicker resolution.

#### NTA Recommendations

1. Effective immediately, the IRS should notify all taxpayers within two weeks whenever it places a freeze on a refund claim. If the freeze is temporary and the IRS is seeking to validate the taxpayer’s claim through third parties, the notice to the taxpayer should so state. If the IRS is contemplating a permanent freeze, CI should give the taxpayer an opportunity to present documentation *before* it makes a decision about whether to classify the claim as fraudulent and should advise the taxpayer of the availability of TAS and Low Income Taxpayer Clinics (LITCs) to assist with the case.
2. Once CI “determines” that fraud exists, it should immediately refer the case to the Examination function or it should immediately notify the taxpayer of his or her right to file a refund suit in a United States district court or the United States Court of Federal Claims. This notification is vital for due process, since CI by its own admission rarely, if ever, refers these claims for prosecution. Thus, taxpayers’ claims now may remain in limbo for years. Because the period for assessing tax never closes where a return is fraudulent, the taxpayer could be subject to assessment of tax on other issues indefinitely for that tax year. And because the taxpayer’s right to file a refund suit does not close until two years after the IRS’ issuance of a notice of disallowance of the claim, the government is subject to suit in perpetuity when a notice of disallowance is not issued.

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3. The IRS should give serious consideration to moving the initial screening outside the Criminal Investigation function. The placement of initial screening within the CI function is not a good fit. The key to detection of overclaims – whether deliberate or inadvertent – is proper case selection. The IRS Examination function has the most experience and expertise in case selection. Where Examination suspects criminal wrongdoing, it should refer cases to CI. Where it does not suspect criminal wrongdoing, there is no benefit to involving CI. The exam function is fully capable of protecting revenue in non-criminal cases and is more likely to achieve accurate case resolutions because it provides taxpayers with notice of proposed changes to tax and affords taxpayers an opportunity to provide documentation. In egregious cases that do not rise to the level of criminal fraud, Examination can propose the civil fraud penalty as well.
4. The IRS should devote additional resources to improving the accuracy of its screening methods. Screening over 100 million refund returns each year is a challenging task, and the IRS will never be able to design an algorithm that is perfect. But it must devote sufficient resources to refining its screening criteria each year to achieve an appropriate balance between revenue protection and taxpayer rights. Moreover, we believe that these screening resources should be placed in the Examination function.
5. The IRS should review CI's policy of freezing refunds for a certain number of years after it "determines" fraud on a taxpayer's return. The IRS should consider whether the revenue effects of reducing the number of years for which it imposes future refund freezes, or even eliminating this basis for imposing future refund freezes, are significant enough to justify the continuing burden on taxpayer rights (particularly since nearly 80 percent of the taxpayers in the TAS sample whose refunds were frozen due to prior-year fraud ultimately received the full amount of the refunds they claimed) as well as the additional costs the agency incurs in working cases that arise from this policy.
6. CI should facilitate a study of a random sample of frozen-refund cases in which the affected taxpayers have not contacted TAS. The sample should include cases in which refunds have been frozen due to a determination of current-year fraud, cases in which refunds have been frozen due to a determination of fraud in a prior year, and cases placed in temporary freeze status. The study should examine the duration of the refund freezes and the various steps in the process as well as the outcomes. While the taxpayers selected for this study should be ones who have not *initiated* contact with TAS, many of these taxpayers will not understand IRS procedures and might be intimidated if contacted by CI or an audit agency like the Treasury Inspector General for Tax Administration. Therefore, we recommend that the study be conducted in conjunction with TAS and that the cases be referred to TAS so that the taxpayers receive assistance in understanding the process and substantiating their claims.
7. When releasing reports of revenue protected by the QRP, the IRS should be more complete in describing the achievements and limitations of the QRP. The amount of revenue protected by the QRP is a significant factor for the IRS in making budgeting decisions and for congressional oversight committees in evaluating the program. To provide revenue protection statistics as if they are clearly correct and talk about having "verified" fraud without pointing out that taxpayers have had no opportunity to rebut the assertion of fraud provides a distorted portrait of the effectiveness of

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the program – both from the standpoint of the amount of revenue actually “protected” and from the standpoint of whether taxpayer rights have been respected to the degree congressional oversight committees might expect from the nation’s tax administrator.

### NTA Recommendation 1

1. Effective immediately, the IRS should notify all taxpayers within two weeks whenever it places a freeze on a refund claim. If the freeze is temporary and the IRS is seeking to validate the taxpayer’s claim through third parties, the notice to the taxpayer should so state. If the IRS is contemplating a permanent freeze, CI should give the taxpayer an opportunity to present documentation *before* it makes a decision about whether to classify the claim as fraudulent and should advise the taxpayer of the availability of TAS and Low Income Taxpayer Clinics (LITCs) to assist with the case.

### IRS Response to Recommendation 1

Beginning March 2006, the Service began sending CP05 notices to taxpayers whose refunds are being held for further review. This notice generates through an automatic process done through master file programming when CI has determined the information submitted on or with a return may be false and additional research is required to make a final determination. Additionally, the notice was updated in late June 2006 to include third party contact information. As of cycle 200621, 77,605 notices have been sent.

Beginning May 2006, the FDCs began issuing one of two letters. The 4115C (Withholding Verification Request) and the 4116C (CI Examination Referral). The 4115C is issued to all taxpayers whose returns contain questionable income/withholding issues, and, if unresolved, will receive a notice of claim disallowance. These returns are forwarded to Accounts Management after allowing the taxpayer 30 days to respond to the letter. If the taxpayer does not provide the requested information or the provided information does not support the return filed. Accounts Management will then issue a notice of claims disallowance. The 4116C letter is issued to taxpayers whose returns have been forwarded to Examination and who have inquired about their tax return. The letter explains that Examination will contact them within 60 days or release their refund.

### NTA Status Update to Recommendation 1

### NTA Recommendation 2

2. Once CI “determines” that fraud exists, it should immediately refer the case to the Examination function or it should immediately notify the taxpayer of his or her right to file a refund suit in a United States district court or the United States Court of Federal Claims. This notification is vital for due process, since CI by its own admission rarely, if ever,

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refers these claims for prosecution. Thus, taxpayers' claims now may remain in limbo for years. Because the period for assessing tax never closes where a return is fraudulent, the taxpayer could be subject to assessment of tax on other issues indefinitely for that tax year. And because the taxpayer's right to file a refund suit does not close until two years after the IRS' issuance of a notice of disallowance of the claim, the government is subject to suit in perpetuity when a notice of disallowance is not issued.

### **IRS Response to Recommendation 2**

As described in 1., a new process has been established to immediately refer to Examination when CI has determined that the income is likely false and there are also refundable credits, i.e. EITC. Taxpayers who inquire on these accounts are issued 4116C letters that explain that their returns have been sent to Examination and that they will be contacted within 60 days. Examination will issue an initial contact letter and, if necessary, a statutory notice of deficiency where the taxpayer is advised of all appeal rights.

Also described in 1., is another new process that has been established for returns without refundable credits where the income on the return has been determined to be likely false. CI immediately sends a new 4115C letter advising the taxpayer of the issue and requesting additional information. If information is not provided or is not adequate to support the return as filed, Accounts Management will issue a notice of claims disallowance where the taxpayer is advised of his/her appeal rights.

### **NTA Status Update to Recommendation 2**

#### **NTA Recommendation 3**

3. The IRS should give serious consideration to moving the initial screening outside the Criminal Investigation function. The placement of initial screening within the CI function is not a good fit. The key to detection of overclaims – whether deliberate or inadvertent – is proper case selection. The IRS Examination function has the most experience and expertise in case selection. Where Examination suspects criminal wrongdoing, it should refer cases to CI. Where it does not suspect criminal wrongdoing, there is no benefit to involving CI. The exam function is fully capable of protecting revenue in non-criminal cases and is more likely to achieve accurate case resolutions because it provides taxpayers with notice of proposed changes to tax and affords taxpayers an opportunity to provide documentation. In egregious cases that do not rise to the level of criminal fraud, Examination can propose the civil fraud penalty as well.

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### **IRS Response to Recommendation 3**

The members of the QRP Executive Steering Committee (ESC) met during the week of July 24, 2006 to evaluate how the IRS should modify its Revenue Protection Program and will be making recommendations shortly thereafter.

For example, the ESC is evaluating other process streams to explore more effective ways of protecting the revenue and is considering proper organizational placement of the Electronic Fraud Detection System (EFDS). The ESC is also exploring studies of overlap of work performed by Criminal Investigation as well as other functions, i.e. the DDb, math error, etc.

### **NTA Status Update to Recommendation 3**

#### **NTA Recommendation 4**

4. The IRS should devote additional resources to improving the accuracy of its screening methods. Screening over 100 million refund returns each year is a challenging task, and the IRS will never be able to design an algorithm that is perfect. But it must devote sufficient resources to refining its screening criteria each year to achieve an appropriate balance between revenue protection and taxpayer rights. Moreover, we believe that these screening resources should be placed in the Examination function.

### **IRS Response to Recommendation 4**

The IRS employs a sophisticated data mining system to review all incoming tax returns that claim a refund to identify potentially false claims. The data mining model is re-trained each year based on characteristics of fraudulent returns detected in prior years, and creates rules to indicate what combination of factors will indicate whether a return is potentially fraudulent or not. Each year when training the data model, submodels may be expanded to ensure that the model more accurately targets particular areas of concern. The IRS strives to not only improve the number of fraudulent returns it detects, but to also decrease the number of legitimate returns it selects for review.

As stated above, the Executive Steering Committee is exploring any overlap of work performed by Criminal Investigation and other IRS operating divisions, including the screening techniques involved in the Dependent Database. This workgroup includes members of the TAS office. The ESC will be making recommendations regarding the organizational placement of the IRS's Revenue Protection Strategy.

### **NTA Status Update to Recommendation 4**

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### NTA Recommendation 5

5. The IRS should review CI's policy of freezing refunds for a certain number of years after it "determines" fraud on a taxpayer's return. The IRS should consider whether the revenue effects of reducing the number of years for which it imposes future refund freezes, or even eliminating this basis for imposing future refund freezes, are significant enough to justify the continuing burden on taxpayer rights (particularly since nearly 80 percent of the taxpayers in the TAS sample whose refunds were frozen due to prior-year fraud ultimately received the full amount of the refunds they claimed) as well as the additional costs the agency incurs in working cases that arise from this policy.

### IRS Response to Recommendation 5

During PY2006, CI began using a module freeze of the current year filing that only controls the most recent return that was filed, rather than an entity freeze that controls the entire account. However, there are 3 conditions where an entity freeze is appropriate. These conditions are (1) Prisoners (2) Individuals previously convicted for a QRP/RPP crimes and (3) Habitual offenders.

A Controls Task Force has been established to update our control procedures and also includes developing procedures for QRP/RPP restitution cases, fugitive files and the IRS C-file.

### NTA Status Update to Recommendation 5

### NTA Recommendation 6

6. CI should facilitate a study of a random sample of frozen-refund cases in which the affected taxpayers have not contacted TAS. The sample should include cases in which refunds have been frozen due to a determination of current-year fraud, cases in which refunds have been frozen due to a determination of fraud in a prior year, and cases placed in temporary freeze status. The study should examine the duration of the refund freezes and the various steps in the process as well as the outcomes. While the taxpayers selected for this study should be ones who have not *initiated* contact with TAS, many of these taxpayers will not understand IRS procedures and might be intimidated if contacted by CI or an audit agency like the Treasury Inspector General for Tax Administration. Therefore, we recommend that the study be conducted in conjunction with TAS and that the cases be referred to TAS so that the taxpayers receive assistance in understanding the process and substantiating their claims.

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### **IRS Response to Recommendation 6**

The Executive Steering Committee is currently working through an action plan and has planned several studies that will include input from the TAS. Additionally, we have implemented systemic solutions to ensure timely resolution of taxpayer accounts.

### **NTA Status Update to Recommendation 6**

#### **NTA Recommendation 7**

7. When releasing reports of revenue protected by the QRP, the IRS should be more complete in describing the achievements and limitations of the QRP. The amount of revenue protected by the QRP is a significant factor for the IRS in making budgeting decisions and for congressional oversight committees in evaluating the program. To provide revenue protection statistics as if they are clearly correct and talk about having “verified” fraud without pointing out that taxpayers have had no opportunity to rebut the assertion of fraud provides a distorted portrait of the effectiveness of the program – both from the standpoint of the amount of revenue actually “protected” and from the standpoint of whether taxpayer rights have been respected to the degree congressional oversight committees might expect from the nation’s tax administrator.

**IRS Response to Recommendation 7** CI, Examination, and Accounts Management have implemented a new process for immediate referral of workload and issuance of taxpayer notices and resolution of accounts. These notices have allowed taxpayers the opportunity to rebut initial false refund determinations. With the new process, Examination and Accounts Management will track QRP referrals. A quality control coordinator will assist in validating statistics and reviewing information sent between CI, Examination and Accounts Management. This will provide the IRS with more accurate QRP reporting.

### **NTA Status Update to Recommendation 7**

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### 2005 ARC – MSP Topic #3 THE CASH ECONOMY

#### Problem

Underreported income (and related self-employment tax) from the so-called “cash economy” is probably the single largest component of the “tax gap.” It may exceed \$100 billion per year. Because income from the cash economy is not subject to information reporting, many of the IRS’s traditional means of enforcement are unlikely to be effective in addressing it. The IRS has a number of initiatives that could be effective if coordinated and pursued more aggressively. However, no single function coordinates research, outreach, and compliance initiatives aimed at improving reporting compliance among cash economy participants. Nor does the IRS give these initiatives the same level of attention as other initiatives, such as those addressing tax shelters or the Earned Income Tax Credit (EITC). The IRS must develop a comprehensive strategy for addressing the cash economy if it is to significantly reduce the tax gap.

#### NTA Recommendations

1. Expand use of EFTPS. Send self-employed taxpayers a letter to remind them when estimated tax payments are due and offer the option of paying electronically, by phone or via automatic monthly (or biweekly) withdrawals from the taxpayer’s bank account free of charge.
2. Revise Form 1040, Schedule C. Include separate lines showing (1) the amount of income reported on Forms 1099 and (2) other income not reported on Forms 1099.
3. Revise business income tax return forms. Include two questions: (1) Did you make any payments over \$600 in the aggregate during the year to any unincorporated trade or business? (2) If yes, did you file all required Forms 1099?
4. Implement more voluntary withholding agreements. Encourage taxpayers to enter into voluntary withholding agreements by agreeing not to challenge the classification of workers who are a party to such an agreement. (Statutory authority exists under IRC § 3402(p)(3), but the IRS may need to work with the Treasury Department to issue regulations before it can use its authority and may prefer additional legislative authority.)
5. Institute backup withholding more quickly. Require mandatory backup withholding to begin more quickly when taxpayers provide an invalid TIN to the payor.
6. Use more of the information available from state and local governments as well as information from Forms 8300 (Report of Cash Payments Over \$10,000 Received in a Trade or Business) when selecting returns for audit and when auditing them.
7. Establish local compliance planning organizations. A local planning organization could work to identify local compliance challenges, direct the IRS's local response, and measure its effectiveness.

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8. Create a cash economy program office. The cash economy program office would coordinate research, outreach, and compliance efforts aimed at improving income reporting compliance among cash economy participants, as the EITC program office has done with respect to EITC compliance.
9. Educate cash economy participants about the benefits of reporting their income and study the effect of such efforts to determine whether they are cost effective.
10. Obtain more and better research. Sponsor research to identify the most effective use of IRS resources after taking into account the direct and indirect effects of IRS activities on tax revenue.

### NTA Recommendation 1

1. Expand use of EFTPS. Send self-employed taxpayers a letter to remind them when estimated tax payments are due and offer the option of paying electronically, by phone or via automatic monthly (or biweekly) withdrawals from the taxpayer's bank account free of charge.

### IRS Response to Recommendation 1

These reminders are already part of EFTPS Online Version 3.0, which is under development and should be delivered no later than FY 2007.

### NTA Status Update to Recommendation 1

### NTA Recommendations 2 and 3

2. Revise Form 1040, Schedule C. Include separate lines showing (1) the amount of income reported on Forms 1099 and (2) other income not reported on Forms 1099.
3. Revise business income tax return forms. Include two questions: (1) Did you make any payments over \$600 in the aggregate during the year to any unincorporated trade or business? (2) If yes, did you file all required Forms 1099?

### IRS Response to Recommendations 2 and 3

The IRS disagrees, at this time, with the NTA's suggestion that the IRS should include a separate line on Form 1040, Schedule C, for the amount of income reported on Form 1099, U.S. Information Return. Requiring all taxpayers to do so would be costly and burdensome, particularly for small businesses. In addition, the Form 1099 data is not required to process the tax return; asking for that information runs counter to the Paperwork Reduction Act.

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Further, we do not believe a separate line would change the behavior of noncompliant taxpayers. If noncompliant taxpayers are not deterred from submitting an erroneous return by the penalty of perjury, it is unlikely that an additional line will cause them to list income they intentionally omitted elsewhere.

The NTA also suggests adding questions on Form 1040, Schedule C, to prompt information return filing. The instructions to Schedule C already inform taxpayers of the filing requirements for such returns and refer them to the General Instructions for Forms 1099, 1098, 5498, and W-2G, catalog # 11409F. These actions might improve compliance and enhance enforcement activities, but only if the taxpayer responds correctly on the forms. Otherwise, the IRS could verify the answers only upon audit.

### NTA Status Update to Recommendations 2 and 3

#### NTA Recommendations 4 and 5

4. Implement more voluntary withholding agreements. Encourage taxpayers to enter into voluntary withholding agreements by agreeing not to challenge the classification of workers who are a party to such an agreement. (Statutory authority exists under IRC § 3402(p)(3), but the IRS may need to work with the Treasury Department to issue regulations before it can use its authority and may prefer additional legislative authority.)
5. Institute backup withholding more quickly. Require mandatory backup withholding to begin more quickly when taxpayers provide an invalid TIN to the payor.

#### IRS Response to Recommendations 4 and 5

Payees may benefit by having more accurate information concerning their tax liability, but there is a trade off on the additional burden to payors where the law does not mandate reporting. In addition, there are many and substantial issues with voluntary withholding agreements. In part, the IRS is concerned about the resource impact of entering into voluntary withholding agreements with businesses and their service providers. We believe that we would have to significantly reallocate resources in the field in order to use voluntary withholding agreements effectively.

### NTA Status Update to Recommendations 4 and 5

#### NTA Recommendation 6

Use more of the information available from state and local governments as well as information from Forms 8300 (Report of Cash Payments Over \$10,000 Received in a Trade or Business) when selecting returns for audit and when auditing them.

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### **IRS Response to Recommendation 6**

The NTA recommends increasing the use of information from state and local governments, Forms 8300, and UI-DIF tools. Examiners have access to the information the NTA suggests. They use the information appropriate for the issues identified on the tax returns assigned to them for examination, including public record information such as real and personal property records.

A State Reverse File Match Initiative (SRFM) Team has been formed to coordinate the use and exchange of information between agencies. The State RAR, State Amnesty, as well as State Reverse Match programs are all part of this initiative. In addition, CTRS data is being utilized in the identification and selection process of the CBRS CURSED cases which are built and classified for SEP and general program workload.

Additionally, we rely upon exchange of information with states, such as Sales Tax Reports on an ongoing basis as provided for by FedState agreements. In some cases these are specific requests for a particular business as an examination progresses, and in other instances an exchange may result in the identification of discrepancies between Federal and state reporting, causing a return(s) to be screened for examination potential..

Overall, we have re-invigorated the Fed/State program and are using more state information in selecting taxpayers for examination.

IRS is continually looking for opportunities to partner with state taxing officials to identify projects and initiatives to address compliance problems. Currently, IRS representatives are working with officials from the California Franchise Tax Board to develop joint initiatives to address the tax gap. If successful, the initiatives will be expanded to other states.

### **NTA Status Update to Recommendation 6**

#### **NTA Recommendation 7**

7. Establish local compliance planning organizations. A local planning organization could work to identify local compliance challenges, direct the IRS's local response, and measure its effectiveness.

### **IRS Response to Recommendation 7**

The IRS has a process in place for Areas to identify local non-compliant industry segments or pockets of non-compliant taxpayers for audits. The Compliance Initiative Project calls for local review and sampling of returns to verify non-

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compliance. The process requires that alternative treatments be considered, such as interaction with local chapters of national organizations and industry representatives. Further, the SB/SE Communications Liaison and Disclosure Division signs off on each Compliance Initiative Project, which provides a systemic process for identifying educational opportunities.

### NTA Status Update to Recommendation 7

#### NTA Recommendation 8

8. Create a cash economy program office. The cash economy program office would coordinate research, outreach, and compliance efforts aimed at improving income reporting compliance among cash economy participants, as the EITC program office has done with respect to EITC compliance.

#### IRS Response to Recommendation 8

The IRS does not agree that creating a Program Office would be an efficient way to address noncompliance in the Cash Economy. The analogy to the Earned Income Tax Credit (EITC) Program Office is misleading. The EITC population is comprised of wage earning taxpayers who, while not a homogeneous group, have many common issues that allow the IRS to segment and approach them with a coordinated and comprehensive strategy through a program office. The Cash Economy, as the NTA reports, is unknown in composition and size and, as a result, would be difficult to address in a similar fashion.

The IRS recently completed the first phase of the National Research Program (NRP) and the data is just becoming available for use. While the IRS believes that a comprehensive and well-coordinated strategy among the various IRS offices might be successful in addressing the issues of the Cash Economy, we must assess the magnitude of the problem and the characteristics of the population before deciding whether to create such a strategy. The SB/SE Division will ask the IRS Office of Research, Analysis and Statistics to assist in that effort.

We are also assessing the impact of the rapid growth of **Card Payment Systems, Internet Payment Systems**, and other emerging **E-Payment Systems** on small businesses. A significant feature of the growth of E-Commerce/E-Business is the impact e-payments systems are having on cash intensive businesses.

### NTA Status Update to Recommendation 8

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### NTA Recommendation 9

9. Educate cash economy participants about the benefits of reporting their income and study the effect of such efforts to determine whether they are cost effective.

### IRS Response to Recommendation 9

The IRS agrees that education and outreach are critical components to increasing compliance among taxpayers. Within the SB/SE Division, the Office of Research and Communications, Liaison and Disclosure are partnering to develop a strategy to reach non-filers through education and then measure the impact of that outreach. This strategy can be broadened to include cash economy participants with a follow-up study to determine the effect of such efforts. Communications, Liaison and Disclosure is also developing a Tax Gap Outreach Strategy that includes educational messages regarding the tax gap. The first message regarding gross income involved a Fact Sheet distributed to the media and external stakeholders regarding requirements for reporting all gross income. This fact sheet appeared in Tax Notes, for example.

### NTA Status Update to Recommendation 9

### NTA Recommendation 10

10. Obtain more and better research. Sponsor research to identify the most effective use of IRS resources after taking into account the direct and indirect effects of IRS activities on tax revenue.

### IRS Response to Recommendation 10

The IRS agrees that, based on available research, there is an indirect benefit to compliance from audits. However, other than the recent CI-sponsored study, the existing estimates are dated. Data from the first phase of the NRP might be used to update these estimates. To date, only estimates of direct benefits have been developed from NRP. Additional research to help determine with more certainty the audits with the greatest indirect benefit may be useful, but defining and building an accurate resource allocation model that actually measures indirect benefit would be difficult, if not impossible.

### NTA Status Update to Recommendation 10

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### 2005 ARC – MSP Topic #4 TRAINING OF PRIVATE DEBT COLLECTION EMPLOYEES

#### Problem

In or around July of 2006, the IRS's Private Debt Collection (PDC) initiative will go into operation. The PDC initiative marks a dramatic departure from traditional federal tax collection practice in that private collection firms will now be seeking payment from taxpayers with delinquent accounts, arranging installment agreements, and obtaining taxpayers' financial information over the phone. The National Taxpayer Advocate is concerned about taxpayers interacting with private collection agents who have no understanding of important tax laws and will be trained by the contractors instead of the IRS. With the abundance of tax experts employed at the IRS, it only makes sense to use the IRS's expertise to directly train private collectors at a level that approximates the training received by new IRS collection employees.

#### NTA Recommendations

1. Expand the topics in the training materials to include topics on which IRS employees are required to be trained, including: financial information interviews, installment agreements, confidentiality, liens, levies, and IRS Office of Appeals. Additionally, PCA employees should be exposed to training on taxpayer rights and the Taxpayer Advocate Service that approximates the training received by IRS employees.
2. The IRS should provide the above-referenced training directly to the first group of PCA employees and utilize those resources currently dedicated to "monitoring" ongoing training sessions to instead conduct the training sessions.
3. If the IRS undertakes future procurements relating to its Private Debt Collection initiative, it should establish a monetary incentive on the contractor's scorecard to encourage the provision of additional training on taxpayer rights and other IRS related topics.

#### NTA Recommendations 1 and 2

1. Expand the topics in the training materials to include topics on which IRS employees are required to be trained, including: financial information interviews, installment agreements, confidentiality, liens, levies, and IRS Office of Appeals. Additionally, PCA employees should be exposed to training on taxpayer rights and the Taxpayer Advocate Service that approximates the training received by IRS employees.
2. The IRS should provide the above-referenced training directly to the first group of PCA employees and utilize those resources currently dedicated to "monitoring" ongoing training sessions to instead conduct the training sessions.

**IRS Response to Recommendations 1 and 2** The IRS regards the appropriate training of private collection agency personnel as critical to the success of this new program and has taken great care to craft a training program that will ensure the same level of proficiency for private collection agency (PCA) employees that is demonstrated by IRS employees. While no PCAs have yet been awarded contracts, and no training has actually begun, we believe the content

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and delivery of IRS specific training material has been properly planned and will be executed in a highly professional manner by both the IRS and PCA personnel involved

The procedures and processes for the implementation of private debt collection for Federal taxes have been created so that the distinction is clear between the inherently governmental functions involved and the tasks to be performed by the PCAs. When contracts are awarded to the selected PCAs, the IRS will supply all materials outlined in the Request for Quotations (RFQ) issued October 13, 2005, and include a comprehensive handbook of procedures developed for use by the PCAs as well as specific documents and videos on: confidentiality of return information, privacy and safeguards, taxpayer rights, the Taxpayer Advocate Service (TAS), the application of the provisions of the Internal Revenue Restructuring Act of 1998, and the role of the Treasury Inspector General for Tax Administration. Documents developed for IRS employees on these subjects will be provided where available. In addition, based on discussions with TAS personnel, the IRS will also include a special video on additional TAS issues. These materials will include specific text and chapters on all necessary topics including data security, taxpayer rights, securing an installment agreement, accounts requiring special processing, recall and return of accounts and the complaint process. Supplying these materials is but the first step in working with the PCAs on a well-developed training plan. The PCAs are also required to submit a training plan for IRS approval. All of these documents will be used as the base for a class taught by the IRS for the instructors and key personnel designated by the PCAs. The IRS expects that topics of interest outlined by the NTA will be discussed in detail and the complexity of the materials will reflect appropriately the needs of the PCA employees in performing their assigned tasks.

This “train-the-trainer” session will be part of the pre-operational certification phase for the PCAs. The IRS plans to monitor the training provided by each firm to ensure that a quality presentation is made. All PCA employees working on this program will also be required to execute the same certifications of training required by IRS employees for critical topics. Support organizations within the IRS will be established to assist the PCAs in working the assigned inventories. IRS employees assigned to these units will be trained and available to work with the PCA employees as each case is worked to ensure the appropriate resolution is achieved. If on-the-job training needs are identified by either the IRS or a PCA, the support units will assist in delivering “just-in-time” training as needed. The IRS will monitor phone calls with taxpayers made by the PCAs and review casework; these review results will assist in identifying any additional training needs on an on-going basis. PCAs and their employees will be held to the same standards of service and rights protection as IRS employees and a customer satisfaction survey will be employed to track taxpayer feedback.

The depth of the interaction between a PCA employee and a taxpayer will not be analogous to a contact between an IRS employee and the same taxpayer. The IRS has designed the inventory selection to include only those cases whose

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attributes allow the type of case resolution intended by the statute. We have excluded cases that would require the additional knowledge of an IRS employee for resolution. When taxpayers claim an economic hardship, PCA employees will not be able to determine if an account can be designated “currently not collectible”. They may only gather financial information and submit the case for an IRS employee to make a decision. The training designed for the PCAs is explicit in this regard. PCA employees will not require the same training as an IRS employee in many instances, and the training program has been tailored to reflect that reality. Complete training on referring cases to the Taxpayer Advocate Service is included in this program. The IRS related training is in addition to any conducted by each PCA on their own topics; most reputable PCAs routinely train their employees on many detailed topics including the provisions of the Fair Debt Collection Practices Act. As an additional note, PCA employees will be requesting payment from taxpayers whose outstanding liability will not be actively assigned within the IRS and meets the criteria for placement with the PCA. While a refund offset or systemic attachment to a governmental payment may occur on these cases, this would have occurred while the cases remain open, even if not assigned to the PCA.

Training material for both PCA and IRS employees has been prepared. The material for IRS employees is a student course book designed for classroom delivery with an expected in-field date of June 30, 2006. The PCA employees training material is a video, completed earlier this year. Training is scheduled as follows:

Week of July 10 – PCA employee training, New Carrollton  
Week of July 17 – IRS employee training, Kansas City Campus  
Week of July 24 - IRS employee training, Philadelphia Campus  
(please note: these weeks may be switched)

The training schedule will be finalized the week of June 28.

### **NTA Status Update to Recommendations 1 and 2**

#### **NTA Recommendation 3**

3. If the IRS undertakes future procurements relating to its Private Debt Collection initiative, it should establish a monetary incentive on the contractor’s scorecard to encourage the provision of additional training on taxpayer rights and other IRS related topics.

**IRS Response to Recommendation 3** As previously stated, the IRS regards the appropriate training of private collection agency personnel as critical to the success of the program. Consequently, the IRS agrees there is merit to establishing

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monetary incentives that will encourage additional training on taxpayer rights and other related topics. This proposal is being maintained on a list of items we plan to address as we update the contracts along with the statement of work in 2007.

### NTA Status Update to Recommendation 3

#### 2005 ARC – MSP Topic #5 EARNED INCOME TAX CREDIT EXAM ISSUES

##### Problem

In the past few years, the IRS has made significant progress in improving the administration of the EITC. Despite this progress, problems still exist for taxpayers subject to EITC examinations and recertification. These problems include delays in exam and recertification procedures, low taxpayer response rates, a lack of standardized treatment in recertification cases, and problems with documentation. The National Taxpayer Advocate recommends that the IRS continue to identify and adopt measures designed to ease the burden on taxpayers and improve the current EITC examination and recertification processes.

1. **NTA Recommendations** Continue developing correspondence (including letters, publications, and document requests) that will lessen taxpayer confusion and generate a greater response from taxpayers during the examination process.
2. Ensure that procedures are in place so that taxpayer correspondence is timely processed and acknowledged.
3. Continue to develop research initiatives and recommendations to improve the administration of the EITC program, including the TAS study to evaluate the impact of representation on the outcome of EITC audits and the study to identify the most significant barriers taxpayers encounter during EITC audits.
4. Ensure that all employees receive clear guidance and training on the application of the two and ten year EITC recertification bans.
5. Continue developing new processes (such as the use of alternative methods of documentation, the decision support tool, and encouraging examiners to use judgment) that will ease the burden taxpayers encounter when trying to provide the IRS with the requested documentation during the exam process.
6. Continue to train EITC examination employees, utilizing real case examples (including TAS cases), on the importance of using judgment when deciding whether to allow or deny an EITC claim.

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7. Use "universal access" in EITC cases to enable any Exam employee to access a taxpayer's case and take the steps necessary to resolve the case, including consolidating all EITC issues pertaining to that taxpayer — examination, audit reconsideration, and recertification — under one employee.

1. **NTA Recommendation 1** Continue developing correspondence (including letters, publications, and document requests) that will lessen taxpayer confusion and generate a greater response from taxpayers during the examination process.

### IRS Response to Recommendation 1

We are working with the NTA to explore the use of new notices to improve the rate of taxpayer response as well as to enhance the overall quality of our communications with taxpayers. The letter CP79, *Taxpayer Inquiry, Earned Income Credit Eligibility Requirement*, which is sent to the taxpayer to explain the recertification process has been revised. A study that actually interviewed the taxpayers for their feedback on the letter was used to make the changes. Additionally, we updated Math Error Code 653 to include language on the recertification process and Form 8862.

The Form 8862, *Information to Claim Earned Income Credit After Disallowance*, which is used by the taxpayer to recertify, was revised to decrease the time needed to complete the form by 50 percent.

The letter CP27, *EIC Potential for Taxpayer without Qualifying Children*, will be generated for a taxpayer who is potentially eligible for EIC without a qualifying child, even when a recertification indicator is on Masterfile. We also reprogrammed our internal systems not to reject electronically filed Forms 1040 or 1040A that claim EITC without qualifying children, when the recertification indicator is present and Form 8862 is not attached.

The letter CP74, *You've Successfully Re-Certified for EIC*, was recently developed to inform taxpayers that they have been recertified for EITC. The recertification indicator is now automatically released when the taxpayer verifies his/her EIC. This allows the taxpayer refund to generate timely the following year.

The letter CP79A notice, *Earned Income Credit Two Year Ban*, to taxpayers advising them of the two-year EITC ban, was revised to display the next year a taxpayer will be eligible to claim the EITC again.

Publication 596, *Earned Income Credit*, contains a new chapter on information dealing with recertification and the recertification process. This chapter was added to explain the recertification process and to help the taxpayer determine if

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and when the Form 8862 is needed. The EITC web page on IRS.gov will link to the new recertification chapter in Publication 596. The web page will also include links to Form 8862 and letters CP79 and CP79A.

The Forms 886-H series, *Supporting Documents for Taxpayers Claiming: EIC on the Basis of a Qualifying Child(ren), Dependency Exemptions or Head of Household Filing Status*, was revised to properly address changes in the tax law as a result of the *Uniform Definition of a Qualifying Child*. Currently, a team which includes members of NTA, W&I Compliance, SB/SE Compliance, SPOC and the EITC Office are working to improve the clarity of the forms so that the taxpayer will clearly understand what they should send in, when and why.

Publication 3498A, *The Examination Process (Examinations by Mail)*, is being revised to enhance the language to adequately address premature Appeals concerns. Analysts working on the 3498A revision team include members from NTA, W&I Compliance, SB/SE Compliance, Appeals and the EITC Office.

### NTA Status Update to Recommendation 1

#### NTA Recommendation 2

2. Ensure that procedures are in place so that taxpayer correspondence is timely processed and acknowledged.

#### IRS Response to Recommendation 2

Examination managers are held accountable to timely work their assigned inventory. Every month, aged cases are reviewed at the HQ level and a report sent to the campuses for response. Managers are given measure goals each year, one of which is to decrease the cycle time of the EITC cases. Campuses are instructed to use standard purge dates, by cycle, to ensure all taxpayers are given the same amount of time to reply before moving a case to the next stage.

In January 2006, W&I Exam instituted Intelligent Call Management on the W&I toll-free phones. This service provides more immediate assistance to the taxpayer by providing a better level of service and reduces the need for the taxpayer to call several times to resolve his case. Exam management reinforces the requirement to address the taxpayer's concerns upfront, the first time they call. By taking this approach, the taxpayer will be better informed and provide a more complete initial response to resolve their case and will help to further reduce cycle time.

### NTA Status Update to Recommendation 2

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### NTA Recommendation 3

3. Continue to develop research initiatives and recommendations to improve the administration of the EITC program, including the TAS study to evaluate the impact of representation on the outcome of EITC audits and the study to identify the most significant barriers taxpayers encounter during EITC audits.

**IRS Response to Recommendation 3** We developed a comprehensive research strategy to increase our understanding of the EITC taxpayer so we can better focus our educational and compliance activities.

The FY 2006 EITC Research Plan includes a project, Identifying Correspondence Audit Barriers Experienced by EITC Taxpayers. The EITC Office is working closely with TAS and Low Income Taxpayer Clinics in developing the survey instrument and survey administration plan. Some of the issues we are addressing in the survey include effectiveness of initial and closing letters, taxpayer burden in gathering substantiation, assistance received during the audit process, and taxpayer evaluation of their interaction with IRS.

### NTA Status Update to Recommendation 3

### NTA Recommendation 4

4. Ensure that all employees receive clear guidance and training on the application of the two and ten year EITC recertification bans.

### IRS Response to Recommendation 4

All Campus Examination employees were given mandatory CPE training in fiscal year 2006, covering the application of the two year EITC ban. Tax examiners are also encouraged to contact HQ for guidance with unique situations and then this information is shared by HQ to all campuses that work EITC to ensure a consistent approach is taken.

We are developing a new report (by the end of fiscal year 2006) to keep track of the number of two year EITC bans being applied each week, by campus. This will ensure that each campus applies the ban at comparable ratios as to EITC denials. These reports will also give us the ability to detect anomalies, which could be caused by inconsistent application of the ban.

Report Generating System (RGS) was enhanced this year to include a 2 year EITC ban “pop-up” to remind the users (both Campus and Field) to consider the ban when EIC is being reduced. This will ensure that an EITC ban is considered by tax examining officials at the Campus, Office Audit or Field Audit.

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### NTA Status Update to Recommendation 4

#### NTA Recommendation 5

5. Continue developing new processes (such as the use of alternative methods of documentation, the decision support tool, and encouraging examiners to use judgment) that will ease the burden taxpayers encounter when trying to provide the IRS with the requested documentation during the exam process.

#### IRS Response to Recommendation 5

We recognize obtaining documentation can put a burden on taxpayers. That is why taxpayer burden is one of the factors we consider when we evaluate potential new approaches to reducing EITC error. It is also, why, as part of the test of a residency certification requirement, we tested affidavits as a form of proof. We found that affidavits could be a reliable and effective means of documentation. However, we believe it is premature to conclude affidavits should become a regular part of the EITC examination process. While affidavits do appear to offer significant promise as a way to reduce taxpayer burden, our testing did not replicate the “real world” conditions of many EITC taxpayers.

In fact, the first year of the test was conducted on 25,000 taxpayers who were randomly distributed across the United States. Thus, the awareness of affidavits was very limited as was the potential for “gaming” these documents. The real question is whether a broader understanding and awareness of affidavits through the EITC population would encourage non-compliant taxpayers to use affidavits as a means of erroneously claiming the credit. Because of this potential for abuse, we have and will continue to further test the affidavits before we adopt affidavits on the scale recommended by the NTA. During the second year of the residency certification test, we concentrated a portion of the test in one geographic area. And during the third year of the test we redesigned the affidavits to make them easier to understand and complete. The results of these subsequent tests will allow us to make a more informed decision about expanding the use of affidavits.

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We also believe that we can address some of the NTA's concern by improving our business processes to ensure consistency across our examiners. To this end, we developed an integrated decision support tool that guides our employees through each EITC examination and focuses their work on the specific audit issue for which each return was selected. Thus, no matter where taxpayers are located, similar situations will receive similar treatment. We continue to add additional functionality to this tool with each update.

At the same time, we want to tap into the collective expertise of our examiners. That is why our Correspondence Examination Procedural training emphasizes the importance of examiners using their judgment in evaluating taxpayer replies and analyzing their cases. Using judgment in all examinations is an established policy that we reinforce at every opportunity. In our training material, examples and exercises explain the different documentation scenarios an examiner may come across when working a case. We encourage the instructors to use "real-life" case situations to make the training as accurate and real as possible. We continue to refresh and reemphasize this message during our annual examiner CPEs.

### **NTA Status Update to Recommendation 5**

#### **NTA Recommendation 6**

6. Continue to train EITC examination employees, utilizing real case examples (including TAS cases), on the importance of using judgment when deciding whether to allow or deny an EITC claim.

#### **IRS Response to Recommendation 6**

We reinforce the use of judgment by examiners as an integral part of the 80/20 concept. We trained all examination employees in the use of this concept. We visited each of the campuses and reviewed cases to determine its usage, and gave spot awards to employees who used it.

We also visited each of the campuses in FY 2005, held focus groups to determine where we were at and what we needed to do to take this concept to the next level.

IRM 4.19.1 was updated to include the use of judgment and sections were deleted that may have been barriers for the use of judgment.

In order to keep 80/20 concept fresh in the minds of employees, a concerted effort is made to reinforce the use of judgment. Directors, Operation Managers and Department Managers continue to be involved in CPEs, Team meetings

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and other activities where the use of judgment is discussed. The use and encouragement of judgment is included in new hire Basic Income Tax Law classes. Managers are closely involved in reviews and provide positive feedback directly to employees who demonstrate proper application of judgment. Work papers supporting decisions based on judgments were provided to the sites for training purposes. Promotional mouse pads that encouraged use of judgment were provided to serve as a daily reminder as well as a motivational item. Program specific training was provided to all examiners including the Audit Recon Teams with examples of cases.

Administrative guidance and operating procedures for responding to disaster cases were provided. The sites were advised that in instances in which a taxpayer claimed to be affected by the disaster, compliance relief should be based on sound judgment and with great sensitivity to the disaster related impact experienced by the taxpayers.

### NTA Status Update to Recommendation 6

#### NTA Recommendation 7

7. Use "universal access" in EITC cases to enable any Exam employee to access a taxpayer's case and take the steps necessary to resolve the case, including consolidating all EITC issues pertaining to that taxpayer — examination, audit reconsideration, and recertification — under one employee.

#### IRS Response to Recommendation 7

In an effort to provide better Customer Service and uniformity by assigning Taxpayers with multiple year issues to the same examiner, W&I prepared RIS # WEX-6-0010 titled "Phone Initiative" that requests functionality for CEAS "Universal Access" for processing year 2007. This RIS will provide universal access beyond the current "view only" option. The functionality will include:

- The ability to transfer a case immediately from one site to another when there has been no prior correspondence on the case.
- The ability for a permissioned user to request the RGS case and AIMS record be transferred from the losing campus in real time.
- A systemic update to RGS and AIMS showing that the case has been transferred out of the losing campus.
- A systemic update to RGS and AIMS showing that the case has been transferred in to the gaining campus.
- A systemic managerial oversight of the transfer process.
- A systemic notification to both the losing and gaining site regarding the transfer

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In another initiative to ensure that Taxpayers with multiple year audits are treated in the same campus, W&I has submitted RIS # WEI-6005 requesting that all Recertification cases are assigned to the campus that currently has an open audit control on a prior tax year.

Examination will also introduce requirements into the Automated Case Workload Management (ACWM) tool for processing year 2007 to assign incoming correspondence to any individual currently working an EITC issue on that same Taxpayer. That functionality will be expanded universally across all campuses upon the receipt of Correspondence Imaging.

### NTA Status Update to Recommendation 7

#### 2005 ARC – MSP Topic #6

#### LEVIES ON SOCIAL SECURITY PAYMENTS

##### Problem

In general, recipients of Social Security benefits are elderly or disabled workers, or the surviving dependents of deceased workers. The IRS continues to process levies on Social Security payments without sufficient managerial review, causing undue burden on a vulnerable population of taxpayers. The National Taxpayer Advocate urges the IRS to implement safeguards that would prevent levies from being imposed on Social Security payments to low income and other at-risk taxpayers.

##### NTA Recommendations

1. The IRS should include a specific due date for response for CP 91 and CP 298 notices.
2. The IRS should develop an algorithm for screening out low income taxpayers from Federal Payment Levy Program (FPLP) and manual levies on Social Security benefits.
3. The IRS should come up with procedures to identify cases that need greater scrutiny before being processed as an FPLP levy.
4. The IRS, on its own and through stakeholders, needs to let taxpayers know how changes in the FPLP rules may affect them, and where to find assistance.
5. The IRS should conduct research on the unique needs of the population of taxpayers receiving Old Age, Survivors and Disability Insurance (OASDI) payments and provide its employees with specific guidance to ensure that it provides the appropriate level and type of taxpayer service.

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6. The IRS should limit manual levies on OASDI payments to flagrant cases, as it does on levies on other retirement assets, or in the alternative, it should levy no more than 15 percent of such payments.
7. The IRS should ensure that its employees follow the procedures set forth in the IRM so that taxpayers are not subject to double levy.
8. The IRS should continue to partner with the SSA and FMS to develop permanent procedures that will ensure prompt processing of levy releases.

### NTA Recommendation 1

1. The IRS should include a specific due date for response for CP 91 and CP 298 notices.

### IRS Response to Recommendation 1

### NTA Status Update to Recommendation 1

### NTA Recommendation 2

2. The IRS should develop an algorithm for screening out low income taxpayers from Federal Payment Levy Program (FPLP) and manual levies on Social Security benefits.

### IRS Response to Recommendation 2

### NTA Status Update to Recommendation 2

### NTA Recommendation 3

3. The IRS should come up with procedures to identify cases that need greater scrutiny before being processed as an FPLP levy.

### IRS Response to Recommendation 3

### NTA Status Update to Recommendation 3

### NTA Recommendation 4

4. The IRS, on its own and through stakeholders, needs to let taxpayers know how changes in the FPLP rules may affect them, and where to find assistance.

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### IRS Response to Recommendation 4

#### NTA Status Update to Recommendation 4

#### NTA Recommendation 5

5. The IRS should conduct research on the unique needs of the population of taxpayers receiving Old Age, Survivors and Disability Insurance (OASDI) payments and provide its employees with specific guidance to ensure that it provides the appropriate level and type of taxpayer service.

### IRS Response to Recommendation 5

#### NTA Status Update to Recommendation 5

#### NTA Recommendation 6

6. The IRS should limit manual levies on OASDI payments to flagrant cases, as it does on levies on other retirement assets, or in the alternative, it should levy no more than 15 percent of such payments.

### IRS Response to Recommendation 6

#### NTA Status Update to Recommendation 6

#### NTA Recommendation 7

7. The IRS should ensure that its employees follow the procedures set forth in the IRM so that taxpayers are not subject to double levy.

### IRS Response to Recommendation 7

#### NTA Status Update to Recommendation 7

#### NTA Recommendation 8

8. The IRS should continue to partner with the SSA and FMS to develop permanent procedures that will ensure prompt processing of levy releases.

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### IRS Response to Recommendation 8

### NTA Status Update to Recommendation 8

#### 2005 ARC – MSP Topic #7

#### APPEALS CAMPUS CENTRALIZATION

##### Problem

The IRS Office of Appeals (“Appeals”) has centralized its work on certain types of cases at six IRS campuses; these cases previously were resolved in field offices closer to taxpayers. Appeals campus centralization is aimed at decreasing the time it takes for a taxpayer to resolve a case. While this aim is appropriate and admirable, the National Taxpayer Advocate is concerned that centralizing Appeals case resolution may actually increase taxpayer burden. Centralization may reduce opportunities for taxpayers to have their cases resolved at the local level, diminish working relationships between taxpayers and Appeals employees, increase emphasis on processing at the expense of independent judgment, and diminish service for low income and unrepresented taxpayers. The National Taxpayer Advocate urges Appeals to alleviate these problems and protect taxpayers’ appeal rights by developing specific training that will help employees carry out Appeals’ independent mission in the campus environment. We recommend that Appeals monitor campus activity to ensure that taxpayers – particularly low income taxpayers – receive full and fair consideration of their cases and are adequately notified of their right to request a case transfer to a local Appeals office.

##### NTA Recommendations

1. Develop campus specific training for campus Appeals employees that will help these employees carry out Appeals’ unique independent mission in the campus environment.
2. Develop quality measures to monitor the impact of campus centralization on taxpayer burdens and Appeal rights.
3. Work with TAS and the Low Income Taxpayer Clinics to identify low income taxpayer problems with campus centralization.
4. Track requests for local office transfers and face-to-face conferences. Also, track transfer requests both granted and denied (and the reasons for denial).
5. Publish consistent and uniform campus Appeals procedures and make these procedures available publicly on the IRS website.

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6. Revise the Initial Contact Letter (Letter 3808(CG)) to clearly indicate that taxpayers have a *right* to have their case transferred to a local office, provided that taxpayers make their transfer request as soon as possible, and that the request is not intended to unreasonably delay the Appeals process.

### NTA Recommendation 1

1. Develop campus specific training for campus Appeals employees that will help these employees carry out Appeals' unique independent mission in the campus environment.

### IRS Response to Recommendation 1

Specialized training for Appeals campus employees was developed and used in the rollout of each campus location.

Each Appeals campus location had its own training plan that was designed and used for the rollout of that site. Each plan addressed the technical needs of the employees based on the types of cases that would be handled at the specified site. All the training plans had some features in common. All the training plans contained "Appeals Basic Training". New Appeals employees require this specialized training in "conference and settlement practices". Whether a new employee is selected from a field compliance location or a campus compliance location, they need this training to prepare them for the Appeals job. The campus employees received this training. The campus training also provided workshops and one-on-one training with on-the-job instructors (OJI's), who were knowledgeable, experienced appeals officers and settlement officers. Throughout the training period, area directors, team managers and OJI's monitored the progress of the employees. Where it was needed, individual employees had their OJI periods extended.

Evaluating the training needs of the campus employees is an ongoing process. Area directors, campus team managers, and the employees themselves are alert for issues that call for additional training. As issues are identified, they are addressed using local training workshops or through the annual CPE (Continuing Professional Education) programs.

CPE programs are developed based on the results of "Needs Assessments" that are completed by Appeals managers and employees. The results are broken down by field and campus and by job series. These results are then used to prepare individualized CPE programs for campus employees and field employees.

### NTA Status Update to Recommendation 1

### NTA Recommendation 2

2. Develop quality measures to monitor the impact of campus centralization on taxpayer burdens and Appeal rights.

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### **IRS Response to Recommendation 2**

IRS does not believe there is a need for Appeals to develop separate quality measures for the Appeals campus operations. Appeals' current quality measures are appropriate whether a case was decided in a field or campus location. The current standards in the Appeals Quality Measurement System (AQMS) apply specific criteria that measure taxpayer burden and appeal rights. Whether a case is a field or campus disposal, the AQMS attributes and sub-attributes measure whether the taxpayer/rep (T/P) was kept informed of the status of the case, whether Appeals advised T/P of his rights and other information appropriate to customer service, whether Appeals appropriately responded to T/P's express or implied inquiries and needs, whether Appeals provided T/P adequate time to present his case, and whether written communications were proper. AQMS data is broken down and reported for comparison purposes by Campus, Field, and Appeals Overall. Appeals has the data already and is using it to monitor the impact of campus centralization.

### **NTA Status Update to Recommendation 2**

#### **NTA Recommendation 3**

3. Work with TAS and the Low Income Taxpayer Clinics to identify low income taxpayer problems with campus centralization.

### **IRS Response to Recommendation 3**

Appeals will work with TAS and the Low Income Tax Clinics to identify low income taxpayer problems with campus centralization.

One issue already identified and being addressed by Appeals is the issue of taxpayers with limited English proficiency. To address this, Appeals is currently participating in a pilot that is testing the use of an "over-the-phone interpreter" (OPI) service. This test is currently being conducted at three Appeals campus sites. If the use of OPI is adopted for service-wide use by the IRS, this could be used in all Appeals locations. Also, Appeals has created bi-lingual positions descriptions (PD's) for appeals officers and settlement officers and these PD's were used in the recruitment for staff at several campus locations.

### **NTA Status Update to Recommendation 3**

## 2005 Annual Report to Congress: The Most Serious Problems Encountered By Taxpayers

### NTA Recommendation 4

4. Track requests for local office transfers and face-to-face conferences. Also, track transfer requests both granted and denied (and the reasons for denial).

### IRS Response to Recommendation 4

Currently Appeals tracks, for each case, whether a conference was held and the type of conference held. Also Appeals tracks cases transferred but only distinguishes between transfers to balance inventories and transfers for all other reasons. Appeals does not currently track whether the transfer was requested by the taxpayer or rep.

Appeals believes it is important to have information about cases transferred at the request of the taxpayer or rep.

The Appeals database system is not currently programmed to capture the information needed to track requests for transfer. Appeals will explore this issue to determine what systems enhancements are needed to capture this information and whether the enhancements or programming are feasible.

### NTA Status Update to Recommendation 4

### NTA Recommendation 5

5. Publish consistent and uniform campus Appeals procedures and make these procedures available publicly on the IRS website.

### IRS Response to Recommendation 5

In general, the Campus Appeals employees follow the same procedures as the Field Appeals employees. The exception is that Campus Appeals employees do not conduct face-to-face conferences with taxpayers. Appeals recently posted "S" docketed procedures on its website. The "S" docketed procedures have been incorporated into IRM 8.4.1, which has been cleared and will be sent to publishing by 7/31/2006. This is the first step in the continuing process to review Appeals campus procedures and make revisions where needed. Appeals procedures published in Internal Revenue Manuals or issued as Interim Guidance are available to the public on irs.gov in accordance with IRS policy.

### NTA Status Update to Recommendation 5

## 2005 Annual Report to Congress: The Most Serious Problems Encountered By Taxpayers

### NTA Recommendation 6

6. Revise the Initial Contact Letter (Letter 3808(CG)) to clearly indicate that taxpayers have a *right* to have their case transferred to a local office, provided that taxpayers make their transfer request as soon as possible, and that the request is not intended to unreasonably delay the Appeals process.

### IRS Response to Recommendation 6

The language in the existing letter is more appropriate than the proposed revised language.

Letter 3808 already explains to a taxpayer that he can request a face-to-face conference at the Appeals office closest to his home or business. The letter clearly tells the taxpayer to call **before** the date set for the phone conference to discuss whether a face-to-face conference might be better. It would be repetitive to say that the request should be made as soon as possible. The language already in the letter is more specific. There are a number of reasons why a request for a transfer would not be approved; it wouldn't be appropriate to describe just one reason, i.e., to say that the request should not be made to unreasonably delay the Appeals process. It would be inaccurate for the letter to state that the taxpayer has a *right* to have his case transferred to a local office, because that's misleading to the taxpayer. It creates the expectation that every request for a transfer will be granted. Not every request will be granted, e.g., a taxpayer can't expect to have his case transferred to a local office after a decision has been reached in the case and communicated to the taxpayer and now the taxpayer wants to go to the local office to try and get a more favorable decision.

### NTA Status Update to Recommendation 6

## 2005 Annual Report to Congress: The Most Serious Problems Encountered By Taxpayers

### 2005 ARC – MSP Topic #8

#### REFUND ANTICIPATION LOANS

##### Problem

Given that a significant percentage of RAL customers are EITC recipients, the IRS has a compelling reason to consider improved oversight of the industry as well as seriously consider alternative refund delivery methods. The IRS contributes to the demand for Refund Anticipation Loans (RALs) by: (1) failing to deliver refunds in the quickest manner possible and (2) failing to provide RAL alternatives for the “unbanked.” It is also unclear if RAL customers fully understand the ramifications of cross-collection provisions in standardized RAL contracts, or if customers would even purchase the products if they were adequately informed of the cross-collection practices. The National Taxpayer Advocate recommends that the IRS review the effect of its Revenue Protection Strategy (RPS) on refund turnaround times and work with the Department of Treasury to develop alternative means of delivering refunds to taxpayers.

##### NTA Recommendations

1. Pursuant to Congressional mandate, work closely with the National Taxpayer Advocate to fully analyze and report on such issues as the Debt Indicator program, cross-collection practices, the use of RALs and refund delivery alternatives.
2. Work with the Department of Treasury, bank regulators, and banking and consumer stakeholders to develop refund delivery alternatives, with a particular focus on EITC benefit delivery alternatives to ensure that taxpayers do not unnecessarily spend EITC benefits on high fees. Two methods worthy of serious consideration are Electronic Benefit Transfer (EBT) and Electronic Transfer Accounts (ETA).
3. Review the effect of the Revenue Protection Strategy (RPS) on refund turnaround times. The IRS should review the feasibility of shortening the RPS timeframes as much as possible.
4. Review the ERO Visitation Checksheet used by SB/SE employees during e-file monitoring visits to determine whether it adequately addresses the requirements of IRS Publication 1345 related to RALs and RACs.
5. Work closely with the Taxpayer Advocate Service to determine the methodology for randomly selecting ERO sites for e-file monitoring visits. By choosing a representative sample, the IRS can determine the rate of noncompliance among the general ERO population. If the rate of noncompliance found during the resulting random visits is high, the IRS needs to review whether the existing warning and sanction structure actually deters noncompliance in a meaningful manner.

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### NTA Recommendation 1

1. Pursuant to Congressional mandate, work closely with the National Taxpayer Advocate to fully analyze and report on such issues as the Debt Indicator program, cross-collection practices, the use of RALs and refund delivery alternatives.

### IRS Response to Recommendation 1

IRS consulted with the Office of the Taxpayer Advocate in drafting the report to Congress as directed by the conferees. Staff of the Advocate and the IRS cooperated fully and worked to develop an outline; secure information from external stakeholders; review drafts of the report; and propose additions, corrections, deletions and edits to the report. The draft addresses the issues identified by Congress in a balanced way, representing the principal positions both pro and con. The draft is currently under review in IRS prior to submission to Treasury for approval.

### NTA Status Update to Recommendation 1

### NTA Recommendation 2

2. Work with the Department of Treasury, bank regulators, and banking and consumer stakeholders to develop refund delivery alternatives, with a particular focus on EITC benefit delivery alternatives to ensure that taxpayers do not unnecessarily spend EITC benefits on high fees. Two methods worthy of serious consideration are Electronic Benefit Transfer (EBT) and Electronic Transfer Accounts (ETA).

### IRS Response to Recommendation 2

The IRS Office of Electronic Tax Administration is in the final stages of the clearance process for the report to congress noted above. While developing this report, the IRS solicited input from the Financial Management Service, several large financial institutions, as well as consumer and taxpayer advocate organizations. As requested by Congress, refund delivery alternatives are addressed in the draft report. These include:

- Refund transfers
- Debit cards
- Gift cards
- Kiosk/cash machine services

### NTA Status Update to Recommendation 2

## 2005 Annual Report to Congress: The Most Serious Problems Encountered By Taxpayers

### NTA Recommendation 3

3. Review the effect of the Revenue Protection Strategy (RPS) on refund turnaround times. The IRS should review the feasibility of shortening the RPS timeframes as much as possible.

### IRS Response to Recommendation 3

The IRS is continually working to deliver taxpayer refunds in as short as time as possible – an approach which we believe will lessen, but not eliminate, demand for RALs. Despite decreasing waits for refunds, large numbers of taxpayers continue to use RALs. There are a number of theories to explain this behavior, but the evidence is only anecdotal. Perhaps the strongest explanation is that RAL consumers have a very short time value of money – that is, they are willing to pay what constitutes an extraordinarily high price to gain near immediate access to their refunds (or a loan equivalent to most of their refunds), rather than wait just a few days and not pay a fee. Even more telling is the high degree of satisfaction RAL users appear to experience – at least according to the Georgetown University monograph the NTA cites. In that paper, Dr. Elliehausen makes a strong case that people who use RALs are happy with the product and at least somewhat aware of the financial transaction in which they have engaged.

It is unlikely that the IRS will ever be able, or necessarily want, to deliver refunds in the near “instantaneous” fashion that taxpayers can obtain RALs. While we will continue to work to shorten the wait time, fraud and error correction screens may add days to the process – days some taxpayers are unwilling to wait if a RAL is available.

### NTA Status Update to Recommendation 3

### NTA Recommendation 4

4. Review the ERO Visitation Checksheet used by SB/SE employees during e-file monitoring visits to determine whether it adequately addresses the requirements of IRS Publication 1345 related to RALs and RACs.

### IRS Response to Recommendation 4

The IRS will review the e-file Monitoring Checksheet prior to the 2007 filing Season to ensure it adequately addresses e-file requirements relating to RALs and other financial products set forth in Publication 1345. If enhancements are needed the Checksheet will be revised in time for the 2007 filing season.

### NTA Status Update to Recommendation 4

### NTA Recommendation 5

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5. Work closely with the Taxpayer Advocate Service to determine the methodology for randomly selecting ERO sites for e-file monitoring visits. By choosing a representative sample, the IRS can determine the rate of noncompliance among the general ERO population. If the rate of noncompliance found during the resulting random visits is high, the IRS needs to review whether the existing warning and sanction structure actually deters noncompliance in a meaningful manner.

### **IRS Response to Recommendation 5**

The IRS will meet with the Taxpayer Advocate Service to discuss its ideas regarding the methodology for randomly selecting ERO sites for e-file monitoring visits and subsequent evaluation of the results of such visits. Since random visits traditionally have identified significantly less noncompliance than either targeted visits or referral visits, the IRS is interested in the Taxpayer Advocate Service's ideas that might result in identification in greater volume of noncompliant EROs.

To the extent any such random visits showed a high rate of noncompliance among the general ERO population, the IRS would attempt to understand the causes for the noncompliance, including the effectiveness of the existing warning and sanction process as well as other factors, such as communication and understanding of rules.

### **NTA Status Update to Recommendation 5**

## 2005 Annual Report to Congress: The Most Serious Problems Encountered By Taxpayers

### 2005 ARC – MSP Topic #9

#### IDENTITY THEFT

##### Problem

Identity theft occurs when someone uses another individual's personal information without permission to commit fraud or other crimes. Although the most common type of identity theft involves consumer fraud, an increasing number of identity theft victims find they need to contact the IRS to untangle their tax accounts. The National Taxpayer Advocate urges the IRS to resolve the tax issues faced by victims of identity theft more quickly and efficiently, which may require coordination between the IRS and other federal agencies.

##### NTA Recommendations

1. To ensure employees follow the revised IRM guidance to make every effort to locate a correct TIN for both taxpayers before using scramble procedures and limit the burden imposed on identity theft victims, the IRS should conduct appropriate training for employees who determine whether to send cases to the SSA.
2. In addition, the IRS should integrate awareness of identity theft into various training modules throughout the operating divisions and functions, so all employees are sensitive to this issue and can refer taxpayers to the appropriate IRS function.
3. The IRS should use an electronic indicator on its master files to mark the accounts of taxpayers who have verified that they have been victims of identity theft.
4. The IRS should meet with Low Income Taxpayer Clinics regarding their experiences representing identity theft victims, who have spent unnecessary time and effort interacting with the Automated Underreporter function to untangle their tax accounts. If there is still a need for procedures that will fence-off wages and protect victims of identity theft, the IRS should develop such procedures immediately.
5. The IRS should create a simple brochure, available in multiple languages, describing the tax issues that may arise from identity theft.
6. Prior to sharing information with any entity, the IRS should require adherence to certain security controls.

##### NTA Recommendation 1

1. To ensure employees follow the revised IRM guidance to make every effort to locate a correct TIN for both taxpayers before using scramble procedures and limit the burden imposed on identity theft victims, the IRS should conduct appropriate training for employees who determine whether to send cases to the SSA

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### **IRS Response to Recommendation 1**

IRM Section 21.6.2.4.2.2 outlines the procedures that IRS employees who perform account/tax law work should follow in conducting preliminary research to determine the legitimate holder of a Tax Identification Number (TIN) which is commonly the Social Security Number (SSN). All IRS employees performing work involving this issue should be aware of these IRM procedures. In brief, the IRM outlines the internal research steps that IRS employees should take to determine the legitimate TIN owner before escalating the matter to the SSA for SSN verification. These instructions require employees to make every effort to determine who the legitimate TIN owner is before asking SSA for verification. We take these steps as a matter of efficiency and customer service because we are aware of the time delay which can result from seeking a formal SSN verification from SSA. However, in situations where diligent internal IRS research cannot determine the legitimate TIN owner, we have no choice but to ask the SSA for SSN verification.

Presently, in an effort to alleviate taxpayer burden associated with the multiple use of a common TIN, we are working with the SSA to reduce the time of SSN verification from two years to approximately one. We have also incorporated guidance into our Letter 239C entitled, Scrambled SSN Clarification to Taxpayer, to advise taxpayers of the option for them to directly contact SSA for SSN verification, which may further reduce the time required for resolution.

We understand that additional improvements are needed and the Identity Theft Program Office is actively working both internally and externally to further refine this process.

### **NTA Status Update to Recommendation 1**

#### **NTA Recommendation 2**

2. In addition, the IRS should integrate awareness of identity theft into various training modules throughout the operating divisions and functions, so all employees are sensitive to this issue and can refer taxpayers to the appropriate IRS function.

### **IRS Response to Recommendation 2**

The IRS has established the Identity Theft Program office to serve as the central point of contact for identity theft related issues. The Identity Theft Program office has taken the lead in developing and implementing a service wide Enterprise Strategy designed to address the issues pertaining to identity theft in the tax administration environment. The three prongs of our Enterprise Strategy are: Victim Assistance, Prevention, and Outreach.

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A key aspect of the Outreach component of our Enterprise Strategy focuses on communication. Throughout FY 2006, we have conducted extensive efforts to educate and inform the public and our employees on identity theft related issues through multiple communications channels, including: print media, informational updates posted on the intranet, SERP alerts, other web-based applications such as the Identity Theft inbox located within the Intranet, presentations, messages posted on IRS hall monitors, revised IRM guidance, etc.

An example of the robust internal and external communication efforts resulting from our Outreach Strategy are the actions taken by the IRS in response to the outbreak of electronic phishing schemes and scams which proliferated at the beginning of the 2006 filing season. Our preemptive actions aimed at thwarting this criminal activity included increasing awareness among taxpayers and employees about what they should look for and how they should respond if they were approached by a phishing scheme aimed at obtaining personal information or undermining the integrity of tax administration.

In addition, the IRS will continue to look for ways to collaborate both internally and externally in an effort to reduce taxpayer burden related to identity theft. The Identity Theft Program Office has worked to develop a referral system with the appropriate functions, such as CI and TAS, to resolve the tax administration issues affecting taxpayers victimized by identity theft. This referral system both increases employee awareness and sensitivity to identity theft issues and facilitates resolution of the downstream effect on taxpayers.

### NTA Status Update to Recommendation 2

#### NTA Recommendation 3

1. The IRS should use an electronic indicator on its master files to mark the accounts of taxpayers who have verified that they have been victims of identity theft.

#### IRS Response to Recommendation 3

The IRS has closing codes in place for the majority of the taxpayer cases impacted by identity theft. These codes differentiate identity theft cases in CI, Taxpayer Advocate Service (TAS), and the Automated Underreporter (AUR) program. However, these closing codes do not alleviate subsequent year filing problems. The Identity Theft Program Office is currently working to develop an indicator that will remain on the taxpayer's account for a defined period of time.

### NTA Status Update to Recommendation 3

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### NTA Recommendation 4

2. The IRS should meet with Low Income Taxpayer Clinics regarding their experiences representing identity theft victims, who have spent unnecessary time and effort interacting with the Automated Underreporter function to untangle their tax accounts. If there is still a need for procedures that will fence-off wages and protect victims of identity theft, the IRS should develop such procedures immediately.

### IRS Response to Recommendation 4

Generally, the situations described in the Advocate's report involving undocumented workers using a stolen or fabricated SSN do not result in the identity theft victim receiving a notice from the IRS of underreported income.

### NTA Status Update to Recommendation 4

### NTA Recommendation 5

3. The IRS should create a simple brochure, available in multiple languages, describing the tax issues that may arise from identity theft.

### IRS Response to Recommendation 5

The IRS developed a comprehensive communication strategy that encompassed multiple outreach channels for the 2006 Filing Season. For example, we created a brochure (Pub 4535), available in English and Spanish, that describes tax issues that may arise from identity theft and provides prevention and victim assistance information. We launched comprehensive identity theft Web pages on both IRS.gov and the IRS' intranet. These web pages include information about identity theft prevention techniques and include "alerts" on new identity theft schemes. The tax year 2005 Publication 17 and the 1040 Instruction Booklet were updated to incorporate guidance which seeks to both prevent and respond to identity theft. In addition, we capitalized on existing distribution channels established through Taxpayer Education and Communications (TEC) and Stakeholder Partnerships, Education & Communication (SPEC) to educate taxpayers on this subject.

### NTA Status Update to Recommendation 5

### NTA Recommendation 6

4. Prior to sharing information with any entity, the IRS should require adherence to certain security controls.

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### **IRS Response to Recommendation 6**

The IRS is currently conducting a comprehensive risk assessment designed to identify potential security vulnerabilities related to identity theft. As part of this process, we are assessing the integrity of our internal security controls as well as certain external security controls collateral to the IRS such as State agencies.

State agencies are governed by Title 26, U.S. Code, Section 6103 (p)(4) and as such, they are required to protect Federal tax information (FTI) in accordance with the requirements of the U.S. Code as well as the policies and procedures outlined in Publication 1075, *Tax Information Security Guidelines for Federal, State and Local Agencies*. Collectively, these information security requirements include computer security (i.e. physical and logical) controls designed to protect FTI from unauthorized access, use, or disclosure. The IRS Safeguards Office performs onsite assessments of State agency facilities to evaluate the security posture and operating effectiveness of such computer security controls. Currently, adherence to the Federal Security Management Act (FISMA) and the applicable National Institute of Standards and Technology (NIST) standards are not mandated for the State agencies receiving FTI.

### **NTA Status Update to Recommendation 6**

## 2005 Annual Report to Congress: The Most Serious Problems Encountered By Taxpayers

### 2005 ARC – MSP Topic #10

#### COMPLEXITY OF THE EMPLOYMENT TAX DEPOSIT SYSTEM

##### Problem

The Internal Revenue Code places significant responsibilities on employers for depositing, reporting, filing, and paying employment taxes. Recent data shows that the IRS assesses failure to deposit (FTD) penalties on one out of every 16 employment tax returns, yet eventually abates more than 60 percent of the FTD penalty amounts it originally assessed. This suggests that the rules and regulations governing federal employment tax deposits are overly complex, presenting significant compliance problems for employers and administrative challenges for the IRS.

##### NTA Recommendations

1. The IRS should conduct research to determine why so many FTD penalties are abated, and commit to lowering the abatement rate significantly.
2. The IRS should use plain language when communicating with taxpayers and provide sufficient information for taxpayers to respond properly.
3. The IRS should test the Employers' Annual Federal Tax Program on a statistically valid sample of taxpayers before making these changes mandatory to determine if the benefits of taxpayer burden reduction outweigh the costs of increased complexity.
4. The IRS should monitor the compliance rates of taxpayers using the redesigned Form 941 and Schedule B to determine if the improvements are working as intended.

##### NTA Recommendation 1

1. The IRS should conduct research to determine why so many FTD penalties are abated, and commit to lowering the abatement rate significantly.

##### IRS Response to Recommendation 1

There has been a steady decrease in the number of FTD penalties assessed/abated and the related dollars in those categories. The IRS acknowledges the high dollar abatement rate, but that was addressed by the Office of Penalties and Interest and TAS' 2004 Task Group's six recommendations. We believe that full implementation of these recommendations in 2006 and 2007 will impact the dollar abatement rate.

The IRS continues to address educational elements that can help taxpayers avoid FTD penalties, but also recognizes that some businesses choose to use withheld taxes to continue business operations. Some of those taxpayers would rather pay the penalty than deposit the funds timely. Since mid-2005, both Publications 15 and 51 have included information for

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taxpayers on how to properly complete the Record of Federal Tax Deposit Liabilities (ROFTL) to prevent the assessment of an FTD penalty based on averaging the tax liability.

The IRS is reviewing the accounts used by TIGTA in Report 2005-30-136, "FTD Penalties have been Significantly Reduced" and, as of June 6, 2006, has found the following:

Reason for Subsequent Penalty Abatement	Count
Tax Abatement PRC 010	30
Misapplied Payments Transferred in from another TXPD	22
Misapplied Payments Transferred from X-Ref EIN	30
Manual TC181 PRC 010	22
TC181 RC-062 PRC-030	5
TC181 RC-062 PRC-022	1

A total of 110 tax periods were reviewed: six abatements due to Reasonable Cause (RC-062); 52 had penalty adjustments due to timely/missing deposits being applied; 30 penalty adjustments due to tax abatements; and 22 penalty abatements due to corrected ROFTL information being provided (PRC-010).

### NTA Status Update to Recommendation 1

#### NTA Recommendation 2

2. The IRS should use plain language when communicating with taxpayers and provide sufficient information for taxpayers to respond properly.

#### IRS Response to Recommendation 2

The CP Notice 136 was reviewed to improve the wording of the notice using a more "plain English" style. The opportunity to reduce the complexity of the language is somewhat limited by the Federal Tax Deposit (FTD) requirements themselves; nevertheless, the 2006 version of this notice was more "user friendly" than previous versions reviewed by the NTA. The 2006 version includes the four lookback quarters' net taxes, so taxpayers will know what IRS records indicate and can

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contact the IRS regarding any discrepancies. Providing the 4 lookback quarters' information, along with the Notice 931 enclosure, makes the CP136 a user friendly notice that has garnered positive feedback from external partners. In addition, we will work on using a more "plain English" style for the 2007 CP 207. Due to program conversion delays from the Legacy System to the Autograph System, the IRS expects the plain language formatted notices to be in production for the first quarter of 2008 (by the 04-30-2008 return due date).

### NTA Status Update to Recommendation 2

#### NTA Recommendation 3

3. The IRS should test the Employers' Annual Federal Tax Program on a statistically valid sample of taxpayers before making these changes mandatory to determine if the benefits of taxpayer burden reduction outweigh the costs of increased complexity.

#### IRS Response to Recommendation 3

In developing the Employers Annual Federal Tax Return Program (Form 944), the IRS considered the NTA's recommendation to run a "test" of the program. After careful deliberation, the IRS decided to deploy the program for all taxpayers who owe \$1000 or less in total Employment Tax annually. Various small businesses entities are extremely pleased that IRS is offering this program and have asked the IRS to explore raising the eligibility threshold.

As to whether a taxpayer will know whether they can file a 944 and when to deposit, the IRS will send notices and information to all eligible "944" taxpayers regarding their 944 filing requirement. The eligibility extract, run on 11/21/05, identified approximately 646,000 taxpayers for the 2006 annual filing program. The IRS estimates another 150,000 new businesses may be eligible as well as an estimated 150,000 businesses that "reactivate", both of which will be advised in writing of their eligibility.

The IRS also recognizes that some businesses will grow and the taxpayer may need to make FTDs. Historic data indicates this may be 6-7 percent of the population, but, similar to the filing provision for Farmers (Form 943), all taxpayers need to be aware of their accruals and make FTDs as appropriate. In addition, included in the 944 regulations is a safe harbor provision for those who "grow out" of 944 and must make monthly deposits in the subsequent year, allowing them to deposit their January 2007 FTD with their February deposit by 3/15/07 without incurring any late deposit penalty.

### NTA Status Update to Recommendation 3

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### NTA Recommendation 4

4. The IRS should monitor the compliance rates of taxpayers using the redesigned Form 941 and Schedule B to determine if the improvements are working as intended.

### IRS Response to Recommendation 4

In a transition year, a temporary spike in errors is normal as taxpayers and practitioners learn about any new form. By far, the most common error IRS has encountered with the redesigned Form 941 is the failure to sign the form on the appropriate signature line or to sign the form at all. This confusion results from the new signature line and other information requested of paid preparers, which was added to enhance preparer compliance.

To deal with the failure to sign the Form 941 on the correct line or at all, the IRS has made certain changes to the Form 941 that will be published for the tax year 2006. These changes include a larger signature line, a bigger "X" next to that line, and changes to the paid preparer section to ensure taxpayers who self-prepare better understand that they do not sign in this section. These changes are on the current 2006 revision of Form 941.

IRS efforts at reducing burden are in response to requests from taxpayers, practitioners, the Small Business Administration and others, virtually all of whom have strongly endorsed the Form 941 redesign effort and the resultant redesigned Form 941. The IRS tested the redesigned form extensively using focus groups and cognitive testing. The 8th grade education standard was used for the form and its instructions and a nationally recognized "plain language" expert was employed in the redesign effort. In addition, a representative from TAS was on the redesign team and helped to craft the final product.

The IRS will continue to monitor Form 941 trends to determine that the forms are working as intended and whether the changes made to the 2006 revision of Form 941 are reducing the confusion with signatures.

### NTA Status Update to Recommendation 4

## 2005 Annual Report to Congress: The Most Serious Problems Encountered By Taxpayers

### 2005 ARC – MSP Topic #11

#### AUTOMATED COLLECTION SYSTEM LEVY RELEASES

##### Problem

Collection efforts through the IRS's Automated Collection System (ACS) can result in levies of bank accounts, wages, or other income such as Social Security. In response to these levies, taxpayers will contact the IRS seeking to enter into a collection alternative, such as an installment agreement. The IRS can also designate an account as "currently not collectible" if the taxpayer can demonstrate a financial hardship. The Internal Revenue Code and Treasury Regulations require that the IRS promptly release levies when taxpayers enter into installment agreements or when they demonstrate the existence of a hardship. Some taxpayers encounter problems with the levy release, including clerical errors, delays that result in additional levies on taxpayer assets or income, or the IRS not returning levy proceeds when a delayed levy release results in additional levies. Delays are also due in part to taxpayers' failure to request expedited levy releases so that the release can be faxed to the third party levy source. The IRS has improved the levy release process for currently-not-collectible accounts and has agreed to consider similar system changes for installment agreements, and require additional training for employees. We encourage the IRS to consider revising its procedures so that all levy releases are assumed to require expedited procedures.

##### NTA Recommendations

1. The IRS should create a systemic warning on its data systems for cases in which installment agreements have been entered into with taxpayers reminding collection representatives to release outstanding levies where appropriate, i.e. where the terms of the installment agreement do not contemplate additional levies.
2. In light of the complexity of levy procedures, the burden to raise the issue of expedited levy releases should be borne by the IRS rather than by the taxpayer. Because it can take two weeks for levy releases to travel by regular mail, the IRS should ask the taxpayer if he or she has a fax number for the levy source so that additional levies do not occur.
3. With respect to the return of levy proceeds in cases where IRS processing delays have resulted in inappropriate levies, the IRS should provide training to ACS collection representatives that the timeliness of the levy release must be considered a factor as to whether or not returning the levy proceeds is in the "best interests of the government."

##### NTA Recommendation 1

1. The IRS should create a systemic warning on its data systems for cases in which installment agreements have been entered into with taxpayers reminding collection representatives to release outstanding levies where appropriate, i.e. where the terms of the installment agreement do not contemplate additional levies.

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### **IRS Response to Recommendation 1**

Levy releases for installment agreements require manual input. However, installment agreements are currently input directly through IDRS, so there is nothing on the ACS system at this time that would trigger a reminder to check for needed levy releases. As suggested by the Advocate, we explored the feasibility of adding a systemic prompt for installment agreements.

However, based on conversations with the MITS programmers for the two different systems involved (IDRS and ACS) for inputting these transactions, this programming can not be accomplished.

Installment Agreements are input on IDRS and levy releases are input on the ACS system and they do not interact with each other. At this time ACS does not have any indicator showing when there is an outstanding levy. ACS comments contain the information (narratives) to indicate if there is an outstanding levy or deleted levy. In lieu of systemic interaction between the IDRS and ACS systems, we are pursuing the feasibility of establishing an indicator in the ACS Alert Section. If this enhancement can be implemented then procedures could be changed to input a specific history code when an installment agreement is established that would read the ACS Alert Section and generate a reminder of an outstanding levy that needs to be addressed.

### **NTA Status Update to Recommendation 1**

#### **NTA Recommendation 2**

2. In light of the complexity of levy procedures, the burden to raise the issue of expedited levy releases should be borne by the IRS rather than by the taxpayer. Because it can take two weeks for levy releases to travel by regular mail, the IRS should ask the taxpayer if he or she has a fax number for the levy source so that additional levies do not occur.

### **IRS Response to Recommendation 2**

ACS employees have the authority to provide a faxed copy of a levy release to the taxpayer and employer if circumstances warrant it, e.g., release needed to prevent over-collection or relieve hardship. If a CNC exception hardship (terminal illness, unemployment etc.) has been determined (financial information not required) the option of faxing a levy release is discussed with the taxpayer. Employees are aware of these procedures and make use of its capability when appropriate. W&I campuses have dedicated clerical staff to ensure that fax levy releases are provided when needed. However, if the taxpayer cannot furnish a fax number or contact number, the only option available is to mail the levy release

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Because of the large number of CNC financial levy release requests and the finite resources dedicated to this work, we would be doing a disservice to the taxpayers who actually have a hardship situation if every taxpayer was given the option to fax any levy release. For the first 6 months of 2006 there have been a total of 82,113 levy releases generated by employees through the ACS system. W&I also faxed 12,955 levy releases in one month to employers for expedited levy releases.

### NTA Status Update to Recommendation 2

#### NTA Recommendation 3

3. With respect to the return of levy proceeds in cases where IRS processing delays have resulted in inappropriate levies, the IRS should provide training to ACS collection representatives that the timeliness of the levy release must be considered a factor as to whether or not returning the levy proceeds is in the “best interests of the government.”

#### IRS Response to Recommendation 3

ACS employees explain the levy release process and its timing to taxpayers when they call requesting levy release. At that time, the assistor should address the timing issues between levy release issuance and IRS receipt of levy proceeds, and make those proceeds part of the collection agreement, if applicable. In those instances where the return of levy proceeds is appropriate, the IRM clearly outlines the procedures for our assistors. We feel the training material currently used for CPE adequately addresses the situations in which we should be releasing levies and returning funds. However, we will include a special emphasis on releasing levies promptly, as well as the identification of situations in which consideration should be given to returning levy proceeds. An IRM Procedural Update (IPU) SERP Alert is being prepared to emphasize the proper procedures when a levy release is part of the case resolution. This will be sent to SERP for posting by the end of June 2006.

The IRS continues to emphasize processing and release of levies in training classes.

### NTA Status Update to Recommendation 3

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### 2005 ARC – MSP Topic #12

#### REGULATION OF ELECTRONIC RETURN ORIGINATORS

##### Problem

Electronic Return Originators (EROs), along with return preparers, are taxpayers' entry point into the tax system and have unprecedented access to taxpayers' financial data and social security numbers. As such, EROs should be closely monitored to protect taxpayers, but the IRS's current regulation of EROs is minimal. The National Taxpayer Advocate recommends the IRS increase its efforts, in part by making more visits to EROs, tracking EROs that are not filing any tax returns, and requiring those non-active EROs to recertify. The National Taxpayer Advocate further recommends that the IRS consolidate end-to-end responsibility for EROs, from approval of applications to monitoring ERO activities, in one IRS organization and develop a long-term strategic plan for the e-file program and EROs to ensure adequate and effective oversight.

##### NTA Recommendations

1. Reevaluate the current e-file application and certification process to ensure that the IRS certifies only qualified individuals or groups to become part of the program.
2. Resume tracking which EROs are not filing any tax returns and require these nonactive EROs to recertify.
3. Consolidate end-to-end responsibility for EROs, from approval of applications to monitoring ERO activities, in one IRS organization to ensure adequate and effective oversight.
4. Increase the number of IRS visits to EROs, including random visits, to ensure that registered EROs are operating within IRS guidelines.
5. Strengthen the current sanction and penalty structure for violations of the *e-file* Program guidelines.
6. Ensure that current sanctions and penalties are imposed and collected consistently as a means to ensure compliance with program guidelines and deter future noncompliance.
7. Develop a long-term strategic plan for the e-file Program and EROs that would unify the various IRS functions involved and ensure effective oversight of all EROs.

##### NTA Recommendation 1

1. Reevaluate the current e-file application and certification process to ensure that the IRS certifies only qualified individuals or groups to become part of the program.

##### IRS Response to Recommendation 1

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The IRS disagrees that a complete reevaluation of the e-file application process is necessary as the current process adequately ensures Principals and Responsible Officials of firms participating in IRS *e-file* are suitable persons. However, ETA is currently considering redefining which individuals in large firms are subject to the IRS suitability check to ensure it is completing the suitability check on the correct individuals.

### NTA Status Update to Recommendation 1

#### NTA Recommendation 2

2. Resume tracking which EROs are not filing any tax returns and require these nonactive EROs to recertify.

#### IRS Response to Recommendation 2

The IRS disagrees with the assertion that this is an important regulatory regime. There is no requirement that an ERO must e-file a return to remain an Authorized IRS e-file Provider. The IRS continues to complete suitability checks of EROs even if the EROs are not e-filing returns until it removes the EROs from participating in IRS *e-file*. After removal the firm must reapply and is subject to the same IRS suitability process as all new applicants for participation in IRS e-file.

### NTA Status Update to Recommendation 2

#### NTA Recommendation 3

3. Consolidate end-to-end responsibility for EROs, from approval of applications to monitoring ERO activities, in one IRS organization to ensure adequate and effective oversight.

#### IRS Response to Recommendation 3

The Electronic Tax Administration (ETA) function within the Wage and Investment Division authorizes EROs and has oversight of the suitability process, while SB/SE is responsible for monitoring and sanctioning.

The ETA was originally responsible for both authorization of EROs and monitoring of the EROs. However, TIGTA issued a report dated September 13, 1999, reference #19940062, and recommended removing the responsibility for monitoring the activities of EROs from ETA. The IRS adopted this recommendation.

### NTA Status Update to Recommendation 3

#### NTA Recommendation 4

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4. Increase the number of IRS visits to EROs, including random visits, to ensure that registered EROs are operating within IRS guidelines.

### **IRS Response to Recommendation 4**

The IRS generally accomplishes monitoring through four types of visits scheduled in the following priority; Referrals, Follow-Up, Random and Targeted. The total number of visits in 2005 were 1,100 of which 268 of the visits were Random (24 percent) and 385 were Targeted (35 percent) visits which is more than half of the total visits.

SB/SE independently determines the number of planned visits using volume of ERO data provided to it by ETA.

### **NTA Status Update to Recommendation 4**

#### **NTA Recommendation 5**

5. Strengthen the current sanction and penalty structure for violations of the *e-file* Program guidelines.

### **IRS Response to Recommendation 5**

The IRS finds the current sanctioning process appropriate as it is based on the IRS' determination of the seriousness of the infraction of IRS *e-file* rules. Sanctions include a written reprimand for minor infractions, suspension from participation in IRS *e-file* of either one or two years for serious infractions and expulsion from participation in IRS *e-file* for grave infractions. The process also allows the IRS to immediately suspend or expel EROs from participation in IRS *e-file* for more serious and grave infractions when appropriate.

### **NTA Status Update to Recommendation 5**

#### **NTA Recommendation 6**

6. Ensure that current sanctions and penalties are imposed and collected consistently as a means to ensure compliance with program guidelines and deter future noncompliance.

### **IRS Response to Recommendation 6**

The IRS regularly reviews and evaluates its administration of its responsibility of ensuring compliance by EROs with the IRS *e-file* rules. The IRS conducts suitability checks promptly and visits EROs at their offices to monitor EROs' *e-file* operations. The ERO compliance program is well-rounded with visits conducted based on complaints received by the IRS, targeted initiatives identified from compliance data, and a random sample of EROs.

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### NTA Status Update to Recommendation 6

#### NTA Recommendation 7

7. Develop a long-term strategic plan for the e-file Program and EROs that would unify the various IRS functions involved and ensure effective oversight of all EROs.

#### IRS Response to Recommendation 7

The IRS does not agree that there is a need to unify the various IRS functions involved in the oversight of EROs. The IRS believes the current separation of responsibilities, as previously recommended by TIGTA and agreed to by IRS, provides effective oversight of EROs. Responsibility for oversight of return preparers and monitoring of EROs is with the SB/SE Division. Responsibility for suitability is vested in ETA.

### NTA Status Update to Recommendation 7

#### 2005 ARC – MSP Topic #13

#### LIMITED SCOPE OF BACKUP WITHHOLDING RULES

##### Problem

Underreporting of individual income tax is the single largest source of the tax gap, accounting for over half of the gross tax gap. Backup withholding is one of the tools available to the IRS as it attempts to narrow the gap. The IRS has the authority to require payors to deduct and withhold tax under certain conditions, such as when a recipient fails to furnish a valid Taxpayer Identification Number. However, the IRS has not implemented the backup withholding program effectively and has failed to provide noncompliant taxpayers with sufficient incentive to fulfill their reporting obligations.

##### NTA Recommendations

1. Explore the benefits and costs of making the TIN matching program mandatory for most payors and study the impact of excluding small payors (less than 10 employees).
2. Require payors to impose backup withholding when a TIN cannot be validated.
3. Implement an automatic reconciliation process for backup withholding.
4. Consistently assess information return penalties under IRC § 6721.

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### NTA Recommendation 1

1. Explore the benefits and costs of making the TIN matching program mandatory for most payors and study the impact of excluding small payors (less than 10 employees).

### IRS Response to Recommendation 1

We believe that the TIN Matching Program is much more successful and more widely promoted than the NTA indicates. While footnote #33 of the NTA's 2005 Annual Report to Congress reports the performance of the program for Interactive matches from 10/2003 through 6/2005, it does not mention the fact that the program also successfully processed over 42 million name/TIN combinations through our bulk processes between March 2004 and June 2005. The program usage has demonstrated a remarkable level of pro-activeness on the part of payors. They clearly are not waiting for the IRS to issue the backup withholding notices; rather, they are taking advantage of the TIN Matching program at a time that suits their needs. Most of our participants have reported using the program throughout the tax year. Current reports show 4,188 payor entities (individual organizations or businesses) and 6,704 users participate in the program. On average, we have enrolled 2,094 payor entities during the two-year program operation period (October 2003 – October 2005).

The Treasury Department has proposed legislation twice to expand use of the program, most recently in the "Good Government Act", although neither proposal was enacted. Further, IRS "markets" the program to employee groups, as well as external users, through the following efforts:

- Including TIN Matching program announcements in quarterly communication plans, including providing informational packets to external payer groups and supplying materials to be posted on their web pages.
- Participating in payor group conferences throughout the year.
- Establishing an intranet site to post informational package materials, FAQ document, Power Point presentation, and publications for use by LMSB, SBSE and TEGE field industry agents.
- Establishing an email address for internal and external customers to communicate directly with a program analyst.
- Participating in tax forums and outreach efforts for the public.

### NTA Status Update to Recommendation 1

### NTA Recommendation 2

2. Require payors to impose backup withholding when a TIN cannot be validated.

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### **IRS Response to Recommendation 2**

We agree that the system could be more effective if backup withholding were imposed immediately by payors who learn of a name/TIN mismatch. It would, however, create a "pay as you go" system for backup withholding similar to the requirements for Forms 941. This would be an additional filing requirement and burden for payors. The IRS also would face both internal and external systemic issues that could be cost prohibitive.

### **NTA Status Update to Recommendation 2**

#### **NTA Recommendation 3**

3. Implement an automatic reconciliation process for backup withholding.

### **IRS Response to Recommendation 3**

We do not concur that a Form 1099 reconciliation process should be a part of the Combined Annual Wage Reporting (CAWR) program. The IRS and the Social Security Administration (SSA) agreed to establish the CAWR program specifically to secure the missing Forms W-2 from employers that SSA could not obtain and to reconcile discrepancies between these documents and return filings.

### **NTA Status Update to Recommendation 3**

#### **NTA Recommendation 4**

4. Consistently assess information return penalties under IRC § 6721.

### **IRS Response to Recommendation 4**

Internal Revenue Code section 6721(3)(d)(2) establishes exceptions for a de minimis number of failures to report correct or missing identification numbers. It states in part,

*"The number of returns to which the de minimis exception applies for any calendar year shall not exceed the greater of 10 or one-half of one percent of the total number of all information returns the filer is required to file during the year. If the number of returns on which the filer fails to include correct information exceeds the number of returns to which the de minimis exception applies, the de minimis exception applies to those returns that will afford the filer the greatest reduction in penalty."*

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This criteria automatically precludes imposing the penalty on a large population of Form 1099 payors with emphasis on the small business filer. Through application of the criteria, approximately 25 to 30 percent of the inaccurate filers are dropped from the penalty process. Still, SB/SE sent out approximately 50,000 proposed penalty notices to payors relating to missing and inaccurate identification numbers for FY 2005. Changing the criteria would bring many more filers into the penalty process.

### NTA Status Update to Recommendation 4

#### 2005 ARC – MSP Topic #14

#### ACCESSIBILITY OF E-SERVICES FOR TAX PRACTITIONERS

##### Problem

The IRS's web-based e-Services suite is available to tax practitioners who are active participants in the IRS e-file program and electronically file five or more accepted individual income tax returns in a filing season. The IRS uses e-Services "as a reward and incentive for e-filing" rather than addressing it from a customer service-oriented perspective. This policy of limiting access to e-Services deprives many highly trained and experienced tax practitioners of an extremely useful and efficient tool, and has the unintended result of making the Electronic Account Resolution program available to preparers without regard to their professional qualifications. The National Taxpayer Advocate recommends that the IRS provide access to e-Services to all practitioners qualified to practice before the IRS pursuant to Circular 230. She also recommends that the IRS expand access to the Transcript Delivery System in e-Services to all taxpayers, while taking the necessary security measures to safeguard confidential tax data on the Internet.

##### NTA Recommendations

1. Expand access to e-Services to all practitioners qualified to practice before the IRS pursuant to Circular 230, while maintaining high security standards. This would entail redesigning the system to allow non-EROs to complete the authentication process.
2. Confirm that access to e-Services, Electronic Account Resolution (EAR) in particular, does not create an opportunity for unenrolled preparers to practice before the IRS in a manner that goes beyond the limits of Circular 230.

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### NTA Recommendation 1

1. Expand access to e-Services to all practitioners qualified to practice before the IRS pursuant to Circular 230, while maintaining high security standards. This would entail redesigning the system to allow non-EROs to complete the authentication process.

### IRS Response to Recommendation 1

We agree that the expansion of e-Services would benefit the IRS, the practitioner community, and taxpayers. As outlined below, we are pursuing options for adding additional groups to e-Services. One of our Information Technology Modernization Vision and Strategy long term goals is to expand the groups and numbers of customers that do business with the IRS through the web. The ultimate long range goal is to provide universal “E” to all taxpayers and tax professionals.

Currently, we have over 160,000 registered users of e-Services and over 225,000 participants in the IRS e-file program in our e-Services Third-Party-Database System. This is significant progress, since the e-Services incentive products, Electronic Account Resolution (EAR), Disclosure Authorization (DA), and Transcript Delivery System (TDS), have only been available for two years. We are pleased with these practitioners' acceptance and use of our e-Services products. However, expansion of these services must be balanced against the security risks associated with delivering tax return data over the Internet and the capacity of our data systems to service additional participants.

So far this year, the IRS has received over 71 million individual e-file returns and, for the first time, e-file receipts exceed paper. IRS elected to make e-Services available to the vast majority of e-filing tax practitioners as an incentive because e-file generates significant cost savings to the government and reduces taxpayer errors. We attribute part of the past two year's e-file success to electronic return originators' acceptance of our e-Services suite of applications.

Consistent with our ability to address authentication issues and implement the necessary system changes, we agree that there are opportunities to expand access to the e-Services incentive products. For example, this past January 2006, the Low Income Tax Clinics were given access to e-Services, including the incentive products. Another group is the Reporting Agents and we are pleased to report that we are working on changes that will give this important group access to e-Services in May 2007. We also agree in principal that the others mentioned by the National Taxpayer Advocate should at some point have access to e-Services, particularly the TDS application.

### NTA Status Update to Recommendation 1

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### NTA Recommendation 2

2. Confirm that access to e-Services, Electronic Account Resolution (EAR) in particular, does not create an opportunity for unenrolled preparers to practice before the IRS in a manner that goes beyond the limits of Circular 230.

### IRS Response to Recommendation 2

We still do not believe that e-Services changed any of the risk factors associated with “inappropriate access”. The information available through e-Services is also available to practitioners and the public through our traditional telephone, correspondence, or walk-in channels. The only difference is in the method of delivery. Providing tax information to a properly authorized taxpayer representative is not inappropriate access, regardless of his or her level of training or enrollment, and denying such access would be inappropriate. In addition, the deployment of e-Services did not change any rules regarding practice before the IRS by electronic return originators or any other tax practitioners.

### NTA Status Update to Recommendation 2

### 2005 ARC – MSP Topic #15

#### MANDATORY BRIEFINGS FOR IRS EMPLOYEES ABOUT THE TAXPAYER ADVOCATE SERVICE

##### Problem

Internal Revenue Code § 7803(c)(2)(C)(ii) requires the National Taxpayer Advocate to develop guidance for all IRS officers and employees, outlining the criteria for referral of cases to the Taxpayer Advocate Service (TAS). The IRS has denied the request of the National Taxpayer Advocate to include TAS training among its annual mandatory briefings for all employees. Instead, the IRS has agreed to provide TAS training to contact employees in the Wage and Investment and Small Business/Self-Employed operating divisions on a one-time basis, and urges TAS to train the rest of the employees through methods such as the IRS intranet, inserts in employee Earnings & Leave statements, and “wallet cards.” The National Taxpayer Advocate urges the IRS to rethink its position and grant her request to make TAS training mandatory for all employees.

##### NTA Recommendations

1. The National Taxpayer Advocate recommends that the IRS assist the Taxpayer Advocate Service and the Commissioner in complying with the requirements of IRC § 7803(c)(2)(C)(ii) by including TAS training among its annual mandatory briefings for all IRS employees. The TAS-developed training will cover the role of the National

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Taxpayer Advocate and the Taxpayer Advocate Service in assisting taxpayers and improving tax administration, as well as the criteria for referral of taxpayer inquiries to local offices of the Taxpayer Advocate Service.

### NTA Recommendation 1

1. The National Taxpayer Advocate recommends that the IRS assist the Taxpayer Advocate Service and the Commissioner in complying with the requirements of IRC § 7803(c)(2)(C)(ii) by including TAS training among its annual mandatory briefings for all IRS employees. The TAS-developed training will cover the role of the National Taxpayer Advocate and the Taxpayer Advocate Service in assisting taxpayers and improving tax administration, as well as the criteria for referral of taxpayer inquiries to local offices of the Taxpayer Advocate Service.

### IRS Response to Recommendation 1

The IRS agrees with the Advocate that our employees are encouraged to take responsibility for assisting taxpayers in resolving inquiries if this can be accomplished within the scope of their position.

The IRS workforce is comprised of “contact” and “non-contact” employees. The two largest IRS divisions, Wage and Investment (W&I) and Small Business/Self-Employed (SB/SE) have a significant workforce of “contact” employees. The W&I Division serves 116 million individual taxpayers with wage and investment income only. The SB/SE Division serves approximately 45 million taxpayers that are fully or partially self-employed individuals and small businesses. The contact employees in these Divisions are the primary points of contact for most taxpayers and constitute the employee base that resolves inquiries within the scope of their positions.

Because all IRS employees do not have public contact, the IRS does not agree with the Advocate that all IRS employees interact with taxpayers on a constant basis, both professionally and personally. Therefore, the IRS does not agree that all employees need to be trained on TAS roles and responsibilities and when/how to refer a case to TAS. The TAS training delivered to contact employees in W&I and SB/SE, specifies the criteria for referring taxpayers to TAS, which includes making determinations on whether a taxpayer meets economic or systemic hardship. The TAS training would not be relevant to the roles performed by our other contact and non-contact employees.

Consequently, the IRS does not want all employees trained to evaluate the taxpayer’s situation, determine if the case meets TAS Case Acceptance Criteria, and refer the case to the local TAS office. Making these determinations is outside the scope of our other contact and non-contact positions, and will likely result in inappropriate referrals to TAS, which is a disservice to taxpayers. The IRS encourages TAS to promote all-employee awareness of their organization by using established internal communication products and services.

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In its final audit report , The National Taxpayer Advocate Needs to Ensure Operations Employees Receive Training to Identify Cases” (Audit # 200110023), the Treasury Inspector General’s Office “found that the Taxpayer Advocate Service (TAS) developed guidance outlining the criteria for identifying cases to be referred to the TAS. The TAS provided

guidance through internal manuals, the IRS Intranet, and criteria awareness training”. Where TAS needed to take corrective action was to “ensure it has provided the training on identifying cases to the intended IRS employees.” Our new training administration system (Enterprise Learning Management System) tracked completion of all students and managers, allowing TAS to ensure that training on identifying cases was provided to the intended employees.

The law requires the National Taxpayer Advocate to develop guidance to be distributed to all Internal Revenue Service (IRS) officers and employees outlining the criteria for referral of taxpayer inquiries to local offices of the taxpayer advocate. The law does not require the IRS to commit to train all of its employees on the role of TAS and TAS criteria. The IRS is training all appropriate contact employees about TAS but recommends that TAS initiate other actions to promote program awareness to all IRS employees, such as, posting information on the IRS’s intranet page, inserting a pamphlet in Leave & Earning statements, and developing and distributing wallet cards.

### **NTA Status Update to Recommendation 1**

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### 2005 ARC – MSP Topic #16

#### ALLOWABLE EXPENSE STANDARDS FOR COLLECTION DECISIONS

##### Problem

Each year the IRS publishes schedules of national and local expense allowance standards. These standards reduce the subjectivity involved when IRS employees consider the collection alternative to pursue when a taxpayer is having difficulty paying the IRS (e.g., an offer-in-compromise, installment agreement, or suspension of collection). However, for any given taxpayer, the expense amounts provided by the standards will not necessarily cover his or her reasonable basic living expenses. The IRS relies on the subjective judgment of its employees to allow more than the standard amounts when appropriate. Many practitioners report that the IRS often fails to allow such additional amounts and uses the standards as an excuse to reject reasonable collection alternatives. Our report discusses a number of reasons that the standards are often inadequate and provides recommendations for improving them, encourages IRS employees to allow additional amounts when appropriate, and addresses practitioner concerns.

##### NTA Recommendations

1. Develop local expense standard amounts that IRS personnel can allow without documentation. The IRS should consider allowing taxpayers to retain enough net income to stay out of poverty, as measured by the Federal poverty guidelines (or some reasonable percentage above them), without documentation (*i.e.*, a floor). The IRS should also consider whether other measures, such as the “Self-Sufficiency Standard” used by a number of states and localities, could be used as a floor.
2. Develop expense standards for every major taxpayer expense category, including healthcare expenses for both insured and uninsured, health insurance costs and childcare (or eldercare). The footnotes in the TAS report identify a number of data sources that the IRS could explore.
3. Reduce the geographic area covered by each standard so that they are more likely to reflect actual expenses in a given area.
4. Provide an additional amount under the local standards for each additional family member even if the family has more than four members.
5. Revise IRM guidance to eliminate any suggestion that IRS personnel cannot allow expenses in excess of the standards.
6. Publicize these changes and train all IRS collection personnel to be flexible in allowing upward deviations from the standards in appropriate cases.
7. Sponsor research into whether IRS collection employees are allowing an upward deviation from IRS expense standards in all appropriate cases, including focus groups with taxpayer representatives and Low Income Taxpayer

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Clinics. Based on the research results, the IRS should revise its quality measures (CQMS and EQ) to track how often the IRS employees erroneously fail to allow an upward deviation from the expense standards.

8. Change the IRS quality measure that tracks the number of deviations from the standards with insufficient documentation. Instead, the quality measure should focus on whether the IRS closed the case, regardless of the outcome, without making a sufficient effort to obtain and analyze relevant documentation.

### NTA Recommendation 1

1. Develop local expense standard amounts that IRS personnel can allow without documentation. The IRS should consider allowing taxpayers to retain enough net income to stay out of poverty, as measured by the Federal poverty guidelines (or some reasonable percentage above them), without documentation (*i.e.*, a floor). The IRS should also consider whether other measures, such as the “Self-Sufficiency Standard” used by a number of states and localities, could be used as a floor.

### IRS Response to Recommendation 1

The ALE standards provide expense allowances for basic living necessities. A taxpayer is not required to document expenses for basic necessities, such as food, housekeeping supplies, apparel and services, and personal care products and services, because they are included in the standards. For expenses not included in the standards the IRS, as does any other creditor, requires the taxpayer to provide proof of expenses.

The Allowable Living Expenses (ALE) were formulated to be a reliable indicator of typical individual living expenses. They were created in response to taxpayer, practitioner and Congressional representative concerns to enhance the public perception of the fairness of the IRS collection process and eliminate the perception of capriciousness in determining the correct amount to collect without causing undue hardship. Many years of applying the standards to collection situations to arrive at fair and successful installment agreements, Offers in Compromise, and suspensions of collection due to financial hardship indicate that the ALE formulation meets this goal.

The ALE are used to reduce subjectivity in determining what a taxpayer may claim as basic living expenses necessary to avoid hardship when the taxpayer must delay full payment of a delinquent tax. The ALE provide a means to treat individual taxpayers fairly without giving an unfair economic advantage to tax debtors over citizens who pay voluntarily. However, the IRS does take into account other necessary expenses that are not covered by the ALE and IRS employees are directed to make exceptions to the application of the ALE when individual circumstances warrant.

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The methodologies used in determining Allowable Living Expenses are statistically valid and reliable. The data sources currently in use are the U.S. Census Bureau, the Bureau of Labor Statistics (BLS), and the Board of Governors of the Federal Reserve System. Government sources are used to formulate the ALE because they are unbiased, utilize large samples, report regularly, and are not severely affected by short-term market fluctuations. These data sources are impeccable and widely relied upon by many branches of government and industry. The data contained in the ALE is formulated from statistically valid core data that is 100 percent accurate at the time the information is collected. The IRS adjusts for market trends by using the Consumer Price Indices (CPI) as a basis and then projects anticipated inflationary increases to arrive at the figures on the current ALE.

However, In the interests of continual program improvement, the IRS indicated in its FY 2006 business plan the intention to explore the existence of additional data sources to further refine the annual formulation of the ALE.

Research shows that attempting to formulate localized standard expenses, other than for transportation and housing, is impractical. It also shows that, of 10,864 cases reviewed, 43 percent of taxpayers actually received allowances that exceeded the established standards.

The IRS researched the effect of the current ALE tables on taxpayers with income at or below the current Federal poverty level definition. While no standard can address every taxpayer situation, research clearly shows that applying the current expense allowance results in no repayment of back taxes until income significantly exceeds the poverty level. Research of expense documentation in 10,864 cases showed that 43 percent were deemed uncollectible after the application of the ALE. The same research indicated that, in 96 percent of all cases, taxpayers claimed expenses, and expenses at some level were allowed in 100 percent of all cases reviewed. In 15 percent of cases reviewed, the taxpayer did not claim a standard expense but employees nevertheless granted an allowance. Research indicates that, using a combination of the ALE tables and individual discretion, IRS employees grant significantly higher allowances than are claimed by taxpayers. In the sample, taxpayers claimed a median expense amount of \$649, while IRS employees actually granted a median expense amount of \$916.

IRS also reviewed the referenced data source for the Self-Sufficiency Standard (SSS) and found many problems with the data. Primarily, the data did not meet the standards that data are accurate, cover a sufficient geographic area, are accepted as reliable, are preferably collected on a regular basis and are defensible. In addition, the SSS reports for the various states use a variety of state and local sources and lack the consistency needed to ensure

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nationwide consistency and fairness. Additionally, the SSS reports cover only thirty-four states, Washington D.C., and New York City. Dates of the SSS reports also vary widely, ranging from 1997 to 2005.

Further, a comparison of IRS standards with those developed by SSS show that the IRS standards are more advantageous to the taxpayer.

- The ALE housing and utility allowances are higher than the housing costs in the SSS.
- The ALE National Standards are higher allowances than food and miscellaneous in the SSS.
- The ALE transportation allowances are higher than in the SSS.

The following table<sup>1</sup> shows the amounts by which the ALE National Standards and Housing and Utilities Standards exceed the SSS amounts for food and miscellaneous<sup>2</sup>, and housing, respectively, for a family of four, for the five counties in the 2002 Missouri SSS report:

<b>County</b>	<b>Monthly Income</b>	<b>ALE Housing</b>	<b>SSS Housing</b>	<b>Difference</b>	<b>ALE Nat'l Stds</b>	<b>SSS Food &amp; Misc</b>	<b>Difference</b>
Bates County	\$2,235	\$977	\$406	\$571	\$941	\$860	\$81
Boone County	\$3,109	\$1,336	\$547	\$789	\$1,042	\$912	\$130
Cass County	\$3,332	\$1,315	\$743	\$572	\$1,042	\$929	\$113
St. Louis County	\$2,796	\$1,091	\$692	\$399	\$1,042	\$889	\$153
Washington Co.	\$2,346	\$926	\$434	\$492	\$941	\$860	\$81

<sup>1</sup> The 2002 Missouri SSS report uses 2002 housing data and 2000 data for food and miscellaneous. Research increased these data by the appropriate CPI's to ensure a fair comparison with the 2006 ALE.

<sup>2</sup> The only National Standards expense categories included in the SSS report are food and miscellaneous. The SSS miscellaneous category includes all other essentials such as clothing, shoes, paper products, diapers, nonprescription medicines, cleaning products, household items, personal hygiene items, and telephone service. Since the SSS miscellaneous category includes the other National Standards expense categories, comparing the National Standards to the SSS food and miscellaneous is a fair and reasonable comparison.

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While the SSS provides numbers for child care and health care, the IRS will allow these expenses, if substantiated and necessary for a taxpayer's health, welfare, and/or production of income. In addition, the IRS does not require payment from taxpayers at or below the poverty level and does not deprive a taxpayer of basic living needs.

### NTA Status Update to Recommendation 1

#### NTA Recommendation 2

2. Develop expense standards for every major taxpayer expense category, including healthcare expenses for both insured and uninsured, health insurance costs and childcare (or eldercare). The footnotes in the TAS report identify a number of data sources that the IRS could explore.

#### IRS Response to Recommendation 2

IRS employees do not rely solely on ALE standards to determine the universe of allowable expenses. The ALE standards are intended to include many, but not all, common living expenses. Expenses such as health care and child care, which are excluded from ALE, are listed as specific expense categories on the Form 433A, Collection Information Statement, in order to ensure that individual circumstances are taken into account. These expenses are allowed, subject to verification.

However, as noted above, In the interests of continual program improvement, the IRS indicated in its FY 2006 business plan the intention to explore the existence of additional data sources to further refine the annual formulation of the ALE.

Thus, as part of its Small Business/Self Employed Collection business plan for Fiscal Year 2006, the IRS initiated a research project to determine the feasibility of further breaking down available data to arrive at additional standard expenses. Suggested TAS data sources were reviewed as part of this effort. The majority of sources were derived from core data already employed by the ALE or did not meet current IRS research data standards.

The IRS anticipates that the completed report will be available in July 2006. The IRS will make that report available to TAS.

### NTA Status Update to Recommendation 2

#### NTA Recommendation 3

3. Reduce the geographic area covered by each standard so that they are more likely to reflect actual expenses in a given area.

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### **IRS Response to Recommendation 3**

IRS, as part of the research project, has explored several means of reducing the geographic application of standards, including the use of U.S. Census tracts. Reducing housing standard geographic areas below the county level is impracticable and produces unintended consequences due to insufficient or economically irrelevant data. Reducing the current standards based on BLS CONUS is similarly impracticable. These research results will be available when the final report is issued in July.

### **NTA Status Update to Recommendation 3**

#### **NTA Recommendation 4**

4. Provide an additional amount under the local standards for each additional family member even if the family has more than four members.

### **IRS Response to Recommendation 4**

Based on gross monthly income, Appendix G of the 2005 ALE provides additional allowances for each member of a family over four. Indeed, no single standard will always accurately represent the needs of every family in all circumstances. The ALE is intended to provide unbiased information to be used as a guideline to determine what a reasonable expense may be.

Preliminary results of research indicate that it may be possible to provide an additional allowance for families with more than four members. The IRS has not decided whether or how to employ this allowance.

### **NTA Status Update to Recommendation 4**

#### **NTA Recommendations 5 and 6**

5. Revise IRM guidance to eliminate any suggestion that IRS personnel cannot allow expenses in excess of the standards.
6. Publicize these changes and train all IRS collection personnel to be flexible in allowing upward deviations from the standards in appropriate cases.

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### IRS Response to Recommendations 5 and 6

The Internal Revenue Manual (IRM) states: “National and local expense standards are guidelines. If it is determined that a standard amount is inadequate to provide for a specific taxpayer’s basic living expenses, allow a deviation. Require the taxpayer to provide reasonable substantiation and document the case file.” In other words, IRS employees are directed by the IRM to deviate from the ALE when warranted. It does not state or imply that the ALE will be used as a cap.

IRS employees do not rely solely on ALE standards to determine the universe of allowable expenses. The ALE standards are intended to include many, but not all, common living expenses. Expenses such as health care and child care, which are excluded from ALE, are listed as specific expense categories on the Form 433A, Collection Information Statement, in order to ensure that individual circumstances are taken into account. These expenses are allowed, subject to verification.

The IRS requires the taxpayer to provide proof of expenses in the same manner as any other creditor. It would be unreasonable and unfair to the compliant public at large for a collection officer to allow undocumented expenses in lieu of payment for delinquent tax. When information is verified, an exception to the ALE can be made, based on reasons of health, welfare, or production of income. The IRS does, however, allow the unchallenged claim of standard expenses to ensure basic needs are being met, and to promote fairness of application among tax debtors. In all cases, if a taxpayer is denied an installment agreement or an OIC, there is a safety net provided by the Independent Administrative Review mandated by the Internal Revenue Code.

The IRS has, in the past, asked for specific case examples that would demonstrate unfair or inflexible application of the ALE standards. In fact, OIC management partnered with the AICPA in an effort to identify situations where it appeared the ALE was applied in an unrealistic or rigid manner. A solicitation to the AICPA's approximately 500,000 members was sent earlier in 2005 to identify cases. Seven members responded to the solicitation and only one was about application of the ALE. The IRS appropriately resolved that matter, which concerned an employee failing to follow IRS guidelines.

Based on the study mentioned above, employees allowed expenses exceeding the standards in 43 percent of the sample cases. Clearly, employees do not read or interpret current guidance to discourage allowing expenses exceeding the standards.

### NTA Status Update to Recommendations 5 and 6

### NTA Recommendation 7

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7. Sponsor research into whether IRS collection employees are allowing an upward deviation from IRS expense standards in all appropriate cases, including focus groups with taxpayer representatives and Low Income Taxpayer Clinics. Based on the research results, the IRS should revise its quality measures (CQMS and EQ) to track how often the IRS employees erroneously fail to allow an upward deviation from the expense standards.

### **IRS Response to Recommendation 7**

As noted above, the IRS has, in the past, asked for specific case examples that would demonstrate unfair or inflexible application of the ALE standards. In fact, OIC management partnered with the AICPA in an effort to identify situations where it appeared the ALE was applied in an unrealistic or rigid manner. A solicitation to the AICPA's approximately 500,000 members was sent earlier in 2005 to identify cases. Seven members responded to the solicitation and only one was about application of the ALE. The IRS appropriately resolved that matter, which concerned an employee failing to follow IRS guidelines.

### **NTA Status Update to Recommendation 7**

### **NTA Recommendation 8**

8. Change the IRS quality measure that tracks the number of deviations from the standards with insufficient documentation. Instead, the quality measure should focus on whether the IRS closed the case, regardless of the outcome, without making a sufficient effort to obtain and analyze relevant documentation.

### **IRS Response to Recommendation 8**

In the absence of any data evidencing a problem, the expenditure of resources to create a system to track requests for deviations from ALE and IRS responses is not justified. If such problems were to arise, however, taxpayers already have the right to a review of requested deviations from the ALE through the IRS management chain of command, the Independent Administrative Reviewer, and the Taxpayer Advocate Service. Rejected Offers in Compromise can also be taken to Appeals. In spite of the many channels available for a problem to surface, it has not. As the NTA notes, there are very few anecdotal examples, and certainly no actual statistical trend, to indicate that the IRS is inflexibly applying the ALE standards.

### **NTA Status Update to Recommendation 8**

## 2005 Annual Report to Congress: The Most Serious Problems Encountered By Taxpayers

### 2005 ARC – MSP Topic #17

#### **INADEQUATE TAXPAYER SERVICE TO EXEMPT ORGANIZATIONS, RESULTING IN UNNECESSARY PENALTIES Problem**

Most tax exempt organizations are very small entities with meager resources and modest budgets that rely largely on the services of volunteers. Tax filing requirements for these organizations are complicated and time consuming. The IRS automatically assesses penalties on these organizations when they do not comply precisely with these complex requirements. Over the last 13 fiscal years, however, the IRS has abated almost 75 percent of the dollars assessed for filing-error penalties on exempt organizations because the organizations later corrected their mistakes. This high abatement rate is an unnecessary waste of IRS resources and indicates that exempt organizations would avoid filing errors if better informed of their filing obligations. Currently, however, the IRS substantially underfunds customer service to exempt organizations; for example, only 60 percent of organizations that call the IRS Tax Exempt and Government Entities Division toll-free help line receive service. The National Taxpayer Advocate urges the IRS to reconsider its funding decisions with respect to exempt organization customer service and better utilize the resources available.

#### **NTA Recommendations**

1. Revise the Form 990 and Form 990-EZ instructions to improve clarity and ease of use. These instructions should particularly be revised to clearly set forth the Schedules A and B filing requirements. Alternatively, revise Forms 990 and 990-EZ themselves to include Schedules A and B as part of the forms.
2. Implement the recommendations made by the TE/GE Customer Account Services 2003 Ogden Campus Study (Ogden Study). Namely, (1) Redefine what constitutes an Information Return Item (IRI) error, and (2) Increase the time allowed for exempt organizations to reply to filing error notices before being penalized.
3. Contact the exempt organizations sampled for the Ogden Study to identify (1) why these organizations made filing errors and (2) what information would have helped them avoid these errors. Use this information to develop an education and outreach strategy to reduce common Form 990 and 990-EZ filing errors.
4. Provide the necessary resources to adequately staff the TE/GE toll-free phone line.
5. Develop partnerships with existing organizations that serve and educate the exempt organization community. These partnerships could help the IRS (1) target and deliver need specific information to exempt organizations; (2) reach more exempt organizations with existing materials, information, and workshops; (3) co-sponsor additional workshops for exempt organizations; and (4) receive feedback from the exempt organization community on how the IRS could best help exempt organizations correctly comply with information reporting obligations.
6. Develop a publication specifically for trustees and directors of exempt organizations such as, “What you need to know about your exempt organization’s tax obligations.”

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7. Develop a tax reporting handbook specifically for small exempt organizations. Alternatively, make the course materials for the small and mid-sized exempt organization workshop available to non-attendees.

### NTA Recommendation 1

1. Revise the Form 990 and Form 990-EZ instructions to improve clarity and ease of use. These instructions should particularly be revised to clearly set forth the Schedules A and B filing requirements. Alternatively, revise Forms 990 and 990-EZ themselves to include Schedules A and B as part of the forms.

### IRS Response to Recommendation 1

The IRS is involved in a major revision of Form 990. The goal is to improve the Form to make it easier for taxpayers to complete, improve transparency to the public, and better serve the IRS's compliance needs. As these major changes affect not only the paper form, but also e-file, the processing of returns, and data transcription and storage, we anticipate the first stage of the Form 990 revision will not be available before tax year 2008. The public will be given the opportunity to comment on the draft of the revised Form in the spring of 2007. In the interim, we made a number of changes to the 2005 tax year form and corresponding instructions, seeking additional information to enhance compliance.

To help the EO community, Exempt Organizations Customer Education & Outreach continues to make the Form 990 a focal point of outreach efforts. In March, 2006, we conducted a well-attended telephone forum, *Tips and Tricks for Completing Form 990*, where we addressed a number of questions about the Form and the 2005 return changes. We posted the script and responses to these questions online. The Form 990 sessions at the National Tax Forum continue to be popular, as are the workshops for Small and Mid-size exempt organizations, which feature a substantial segment on Form 990 preparation.

### NTA Status Update to Recommendation 1

### NTA Recommendation 2

2. Implement the recommendations made by the TE/GE Customer Account Services 2003 Ogden Campus Study (Ogden Study). Namely, (1) Redefine what constitutes an Information Return Item (IRI) error, and (2) Increase the time allowed for exempt organizations to reply to filing error notices before being penalized.

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### IRS Response to Recommendation 2

The IRS has taken a number of steps to address issues raised in the 2003 Ogden Campus Study. We have developed 3 proposals to reduce penalty assessments. These are being evaluated in tests that are currently underway in Ogden. The proposals are:

1. Contact an organization by telephone to request missing return information as a means of meeting the requirement of sending the first IRI letter.
2. Authorize Submission Processing tax examiners to accept oral statements as certification that the organization is not required to file Schedule B (Form 990, 990-EZ or 990-PF), Schedule of Contributors.
3. Authorize Submission Processing tax examiners to accept oral statements as clarification as to whether the organization has correctly checked the "Final" box on their return and is truly terminating, merging, or otherwise ceasing operations.

Effective in 2006, we developed three new notices, CP-141 L, I and C. Each more clearly explains why the organization received the notice -- the return was late, incomplete, or both late and incomplete. These are now in use.

Further areas of inquiry regarding the IRC § 6652(c)(1) penalty include an evaluation of an updated list of IRIs or "crucial line items," and a revised incomplete return program

We note that the 2003 Ogden Campus Study addressed penalty notices for late filing, incomplete returns, or both, but did not address error notices, nor did it recommend increasing the time to reply. These time frames are statutorily based.

### NTA Status Update to Recommendation 2

#### NTA Recommendation 3

3. Contact the exempt organizations sampled for the Ogden Study to identify (1) why these organizations made filing errors and (2) what information would have helped them avoid these errors. Use this information to develop an education and outreach strategy to reduce common Form 990 and 990-EZ filing errors.

### IRS Response to Recommendation 3

Exempt organizations – especially small ones – are often run by volunteer officers who serve relatively short terms before relinquishing their duties to another individual. For this reason, we did not contact the organizations sampled for the 2003 study because we likely would not have been able to reach the individuals who prepared the returns involved in that study.

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The outreach efforts described in response to Recommendations 1, 6, and 7 outline educational efforts directed toward reducing filing errors. We also identify ways to educate filers through contact with the campus. For example, we recently identified filers attaching multiple returns together, or using non-IRS approved forms. In response, EO Customer Education and Outreach issued a notice to the public.

The Ogden Campus, in coordination with TE/GE, is currently conducting a test where telephone contact is made with organizations filing incomplete returns. This personal contact results in educating the organization, on a one-on-one basis, of the need for certain required information, and is expected to result in a reduction in common filing errors in the future.

### **NTA Status Update to Recommendation 3**

#### **NTA Recommendation 4**

4. Provide the necessary resources to adequately staff the TE/GE toll-free phone line.

#### **IRS Response to Recommendation 4**

TE/GE's Customer Accounts Service call site will be realigned with the Wage & Investment (W&I) operating division as of October 1, 2006. With greater resources, W&I will eventually increase staffing resources and hours of operation, provide a back up site, and use technology to improve level of service.

### **NTA Status Update to Recommendation 4**

#### **NTA Recommendation 5**

5. Develop partnerships with existing organizations that serve and educate the exempt organization community. These partnerships could help the IRS (1) target and deliver need specific information to exempt organizations; (2) reach more exempt organizations with existing materials, information, and workshops; (3) co-sponsor additional workshops for exempt organizations; and (4) receive feedback from the exempt organization community on how the IRS could best help exempt organizations correctly comply with information reporting obligations.

#### **IRS Response to Recommendation 5**

The IRS's EO Customer Education and Outreach continues to work to expand its efforts to develop partnerships with organizations that serve and educate the exempt organization community. Our communication plan includes contacting

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large associations of exempt organizations and/or their state affiliates, state charity officials, practitioner groups, university related nonprofit management programs, and the nonprofit media, and encouraging them to bring to the attention of their constituents the EO Update, upcoming outreach events, and various website features, including our detailed Lifecycles. We also encourage organizations to link directly to our website and to advertise our services, particularly the EO Update.

We are exploring ways to “piggyback” on the outreach resources of SB/SE, and are working with other business units, including EP, to expand our marketing efforts. Although we hoped to survey our current EO Update subscribers to better assess their needs, the cost of a survey is prohibitive at this time. We will continue to explore other ways to analyze our stakeholders’ needs. We continue to provide speakers at conferences and workshops sponsored by stakeholders, although budget constraints limit this activity.

Our phone forums, a new means of reaching larger audiences efficiently, are popular and filled to capacity. We are now posting the scripts (which incorporate the Q&As) on our website so those who are not able to participate can still benefit from the information.

### NTA Status Update to Recommendation 5

#### NTA Recommendations 6 and 7

6. Develop a publication specifically for trustees and directors of exempt organizations such as, “What you need to know about your exempt organization’s tax obligations.”
7. Develop a tax reporting handbook specifically for small exempt organizations. Alternatively, make the course materials for the small and mid-sized exempt organization workshop available to non-attendees.

#### IRS Response to Recommendations 6 and 7

The IRS does not have a specific publication for trustees and directors, but we emphasize the importance of “good governance” practices in our Exempt Organization publications, including the Compliance Guide for section 501(c)(3) Organizations, and in our website materials.

EO Customer Education and Outreach has recently contracted for the development of interactive online training that will make the information from our Small and Mid-size Workshop Program available to our stakeholders who are unable to attend the workshops. This program will also be of value to trustees and directors as an additional source of information about an exempt organization’s tax obligations.

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The EO Customer Education and Outreach function focused on educating exempt organizations about their filing obligations. Among other things, it (1) posted the most common filing errors on the IR Website; and (2) prepared and disseminated specialized publications.

As our stakeholders have told us, the world communicates with its customers via the Internet , as does the IRS generally. Each of our EO publications is available on the web. Each can be instantly accessed by exempt organizations in any location and downloaded. In May, 2006, we recorded 266,682 page views and 173,161 visits to our site where these publications are posted.

We will continue to evaluate the need for specialized publications.

### **NTA Status Update to Recommendations 6 and 7**

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### 2005 ARC – MSP Topic #18

#### DIRECT DEPOSIT OF INCOME TAX REFUNDS

##### Problem

Under present law, there are no procedures for the IRS, the government's Financial Management Service, and financial institutions to address inadvertent errors by taxpayers relating to direct deposits of tax refund checks. The taxpayer and the financial institution must resolve any dispute over the accuracy of a direct deposit refund, with little assistance from the IRS. The National Taxpayer Advocate recommends that the IRS consider all of the recommendations put forth by the Direct Deposit Task Force as well as other procedural improvements that can eliminate the potential for a misdirected direct deposit refund. The National Taxpayer Advocate also encourages the IRS to continue to work with financial institutions in an effort to recover misdirected funds.

##### NTA Recommendations

1. Continue to work with financial institutions in an effort to recover misdirect funds.
2. Consider all of the recommendations submitted by the Direct Deposit Task Force, as well as any other procedural improvements, that can eliminate the potential for a misdirected direct deposit tax refund.
3. Work to educate taxpayers on the importance of accurately listing account information when requesting direct deposit of a tax refund.

##### NTA Recommendation 1

1. Continue to work with financial institutions in an effort to recover misdirect funds.

##### IRS Response to Recommendation 1

When a misrouting does occur, our procedures instruct tax examiners to work with FMS, the taxpayer and financial institutions to resolve the misdirected deposit. The IRS will contact the financial institution and request a return of the money. If the financial institution does not comply with our request, the taxpayer is sent a letter explaining what happened to the refund and advising that they should contact the institution to resolve the erroneous deposit.

The actions the IRS can take are limited due to the requirements enforced by the financial institutions. The process used by financial institutions for determining if a designated bank account is the same as the name of the depositor is a voluntary one. Financial institutions are not required to verify this information. In addition, federal and state banking regulations contribute to the difficulties in securing information to assist in resolving taxpayer misrouting errors. For

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example, the identity of the party receiving a misdirected refund is rarely known to the Service and is not readily available from banks due to privacy rules.

Contrary to the Taxpayer Advocate's description of IRS' authority to remedy this problem, an erroneous refund suit is rarely a viable alternative. While a misdirected deposit by the taxpayer may constitute an erroneous refund, as noted above, the identity of the third-party recipient is rarely known. All the Service has is an account and a routing number. Financial institutions have an obligation to protect the privacy of their customers and, as such, it is unlikely that attempts to secure identifying information with respect to the bank's customers will be voluntarily forthcoming. Even if information regarding the identity of the bank's client was voluntarily made available, determining whether to file suit would also involve considerations of cost, litigation parameters, and statutes of limitations. These factors rarely favor litigation as a recovery vehicle for the government.

### NTA Status Update to Recommendation 1

#### NTA Recommendation 2

2. Consider all of the recommendations submitted by the Direct Deposit Task Force, as well as any other procedural improvements, that can eliminate the potential for a misdirected direct deposit tax refund.

#### IRS Response to Recommendation 2

As part of our continued commitment to address the concerns raised by the Taxpayer Advocate, W&I Accounts Management developed an action plan addressing the recommendations submitted by the Direct Deposit Task Force.

As of June 1, 2006, the following action items have been completed:

- W&I coordinated with ETA recommending software be updated to include Routing Number (RTN) and account verification. The three major e-file software developers, Turbo Tax, Tax Cut and H&R Block, all have added an extra step to verify RTNs and account numbers. We expect the smaller companies will do the same.
- W&I worked with Publishing to reword the "Caution" statement in the 1040 instructions pertaining to the RTN and account number.
- W&I contacted Financial Management Service (FMS) regarding revising the FMS Form 150.1, Official request from the Dept. of Treasury to the bank on behalf of the taxpayer to search for Electronic Funds Transfer. Several suggestions have been submitted to FMS which they are currently reviewing.

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- IRM 21.4.2, Refund Trace & Limited Payability, was updated to reduce the time frames to initiate a refund trace on non-receipt of direct deposits. Internet Refund Fact of Filing (IRFOF) and Telephone Routing Interactive System (TRIS) were also updated to reduce the time frames for providing refund status.
- W&I submitted a change request (CR) to improve the automated refund trace capability on Where's My Refund (IRFOF) and TRIS that is currently pending funding.

### NTA Status Update to Recommendation 2

#### NTA Recommendation 3

3. Work to educate taxpayers on the importance of accurately listing account information when requesting direct deposit of a tax refund.

#### IRS Response to Recommendation 3

To address and prevent potential taxpayer or practitioner routing errors, all of the software certified by IRS for IRS e-file contains validity checks of the bank and account numbers (for example, they cannot contain non-numeric characters). As noted above, the three major software developers added an extra step to verify RTNs and account numbers by requiring the banking number/account number be entered twice to catch typographical errors. In addition, we have improved the "TIP" area in the Form 1040 Instructions to increase the prominence of the routing and account number instructions and cautionary notes regarding the fact that IRS is not responsible for a lost refund if the taxpayer enters incorrect direct deposit information. This is because in situations where monies were accurately directed by IRS to the account specified by the taxpayer, albeit in error, IRS does not have legal authority to issue a replacement refund.

### NTA Status Update to Recommendation 3

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### 2005 ARC – MSP Topic #19 INNOCENT SPOUSE CLAIMS

#### Problem

One spouse (called the “innocent spouse”) may apply to the IRS for relief from joint liability for deficiencies or underpayments attributable to the other spouse. The IRS has difficulty communicating with taxpayers regarding the requirements for relief and how to fill out related forms. As a result, the IRS is able to grant fewer than three in ten requests for relief, and despite recent cuts in processing time, the IRS collectively takes more than two years to process requests that are appealed. Various IRS computer systems contain inconsistent information about innocent spouse claims processed by the Appeals function. These inconsistencies make it more difficult for the IRS to identify the source of any processing delays.

#### NTA Recommendations

1. Revise Form 8857, Request for Innocent Spouse Relief (And Separation of Liability and Equitable Relief). Taxpayers seem to have great difficulty determining which year to include on the form. Instructions included with Form 8857 should include examples and step by step instructions showing taxpayers which year(s) they should include and how to determine which years may be eligible for relief. We further recommend that the Innocent Spouse Task Force consult with representatives of taxpayers who file and prepare Form 8857, particularly Low Income Taxpayer Clinic staff and volunteers, who are very familiar with the difficulty that low income taxpayers have in navigating the tax system and who are very experienced in effectively communicating with their client base.
2. Create a toll-free phone number. The IRS should implement the Innocent Spouse Task Force’s recommendation to create a special toll-free number for taxpayers to contact the IRS with innocent spouse questions. The number should also be included on the Form 8857 as a resource for assisting taxpayers in determining the correct year to include. For taxpayers calling about a pending request for relief, whenever possible, the call should be routed to the CCISO employee who is working to make a determination on their case.
3. Implement Innocent Spouse Task Force Recommendations. The National Taxpayer Advocate applauds the IRS’s decision to create the Innocent Spouse Task Force to recommend ways to improve communications with taxpayers and practitioners. We recommend the IRS seriously consider all of its recommendations and suggest the task force consult with representatives of taxpayers.
4. Inform Taxpayers of their Right to Seek Relief. The IRS did not inform taxpayers whose claims were erroneously denied as untimely that it will now consider their claims timely as a result of the 2004 holding in *McGee v. Commissioner*. The IRS knows about 6,000 such claims were involved and could determine who submitted them. The IRS should send these taxpayers a letter to inform them the IRS would now consider their claims on the merits.

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5. Outreach and Education. When the IRS implements changes to the Innocent Spouse program, such as those recommended by the National Taxpayer Advocate, it should communicate such changes to taxpayers through targeted outreach and education efforts.
6. Date Stamping Form 8857. Campus processing procedures for IRS employees who open mail should make clear that they need to date stamp Form 8857 upon receipt. These employees rely on IRM § 3.10.72, which includes a list of correspondence that requires a date stamp. This list does not include Form 8857. Specifically, the IRS should revise IRM § 3.10.72 so the appropriate employees are aware of the date stamping requirement.
7. Reconsideration Process. The IRS should reconsider innocent spouse determinations when taxpayers provide new information, just as it reconsiders all other liability determinations pursuant to its audit reconsideration process when taxpayers provide new information. In its response, the IRS notes, "the statute does not permit the IRS to apply the same audit reconsideration procedures to innocent spouse claims as it uses for audit deficiency assessments." The IRS may be focusing on the fact that the Code expressly authorizes the IRS to rescind a notice of deficiency with the taxpayer's consent, but does not expressly authorize the IRS to rescind a final determination under the innocent spouse rules. To be clear, however, we do not suggest that the IRS should rescind a final determination, but rather that the IRS reconsider relief when appropriate after a final determination has been made. The Code does not prohibit such a procedure, and the IRS should implement it without delay.
8. Reconcile Inconsistent Computer Systems. The IRS should continue its initiative to reconcile the differences between ISTS and ACDS. Once it has good consistent cycle time data, management will be better able to detect the real source of any delays.
9. Study Ways To Further Reduce Processing Time. The IRS should sponsor research to determine how it can reduce the time a given taxpayer has to wait for determinations by Compliance and/or Appeals. In researching this issue, the IRS should conduct interviews and focus groups with taxpayer representatives, including Low Income Taxpayer Clinics, as well as taxpayers, to determine what are the sources of delays and confusion from the perspective of taxpayers and their representatives.

### **NTA Recommendation 1**

1. Revise Form 8857, Request for Innocent Spouse Relief (And Separation of Liability and Equitable Relief). Taxpayers seem to have great difficulty determining which year to include on the form. Instructions included with Form 8857 should include examples and step by step instructions showing taxpayers which year(s) they should include and how to determine which years may be eligible for relief. We further recommend that the Innocent Spouse Task Force consult with representatives of taxpayers who file and prepare Form 8857, particularly Low Income Taxpayer Clinic staff and volunteers, who are very familiar with the difficulty that low income taxpayers have in navigating the tax system and who are very experienced in effectively communicating with their client base.

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### IRS Response to Recommendation 1

Innocent Spouse HQ formed a Task Team to develop a more “user friendly” Form 8857 (*Request for Innocent Spouse Relief*) which will provide clearer instructions to the TP and hopefully will result in a significant reduction to the number of non-qualifying claims received. The Task Team included members of Office of Taxpayer Burden Reduction, Taxpayer Advocate, Appeals, CARE, Chief Counsel, Innocent Spouse Operations, Research and Statistics, and W&I Reporting Compliance. Development of the form is complete and the team is in the last stages of perfecting the instructions. Focus groups were held with Innocent Spouse employees, the Taxpayer Advocacy Panel, members of the Low Income Tax Clinic staff, Appeals, and members of the state tax offices in California, New York, and Utah to discuss concerns with the redesigned form. Feedback from the focus groups was incorporated into the new form. The team will conduct focus groups with taxpayers to test the revised form. Changes were also implemented into the Innocent Spouse Tracking System (ISTS) to enable us to track the impact the redesigned Form 8857 will have on reducing the nonqualifying and disallowed rate. Forms and Publications will conduct five focus groups in July 2006 to test the revised Form 8857. Comments from the focus groups will be considered and changes made to the Form 8857 accordingly. This form is projected to be available in August or September 2006.

### NTA Status Update to Recommendation 1

#### NTA Recommendation 2

2. Create a toll-free phone number. The IRS should implement the Innocent Spouse Task Force’s recommendation to create a special toll-free number for taxpayers to contact the IRS with innocent spouse questions. The number should also be included on the Form 8857 as a resource for assisting taxpayers in determining the correct year to include. For taxpayers calling about a pending request for relief, whenever possible, the call should be routed to the CCISO employee who is working to make a determination on their case.

### IRS Response to Recommendation 2

We evaluated costs of implementing various toll free systems and included a request for a toll-free number and complete Aspect system in the FY 2008 Compliance Initiatives that are currently under consideration.

### NTA Status Update to Recommendation 2

#### NTA Recommendation 3

3. Implement Innocent Spouse Task Force Recommendations. The National Taxpayer Advocate applauds the IRS’s decision to create the Innocent Spouse Task Force to recommend ways to improve communications with taxpayers

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and practitioners. We recommend the IRS seriously consider all of its recommendations and suggest the task force consult with representatives of taxpayers.

### **IRS Response to Recommendation 3**

Contacts were made with numerous organizations, e.g., Innocent Spouse employees, W&I employees, the Taxpayer Advocacy Panel, representatives from the Low-Income Tax Clinics, Taxpayer Advocate Service, National Public Liaison, Appeals, and the States of California, New York, and Utah. All comments were considered and adopted if appropriate.

### **NTA Status Update to Recommendation 3**

#### **NTA Recommendation 4**

4. Inform Taxpayers of their Right to Seek Relief. The IRS did not inform taxpayers whose claims were erroneously denied as untimely that it will now consider their claims timely as a result of the 2004 holding in *McGee v. Commissioner*. The IRS knows about 6,000 such claims were involved and could determine who submitted them. The IRS should send these taxpayers a letter to inform them the IRS would now consider their claims on the merits.

### **IRS Response to Recommendation 4**

All requests for reconsideration received from taxpayers that contacted the IRS because of the court decision in *McGee v. Commissioner* were honored. In addition, CCISO reworked all existing open impacted claims. It should also be noted that the IRS issued a notice that was published in the Federal Register with guidance on the McGee decision and publication of the notice did receive media coverage.

A review was also conducted of all claims (6,248) previously denied for being untimely prior to the McGee court decision. We determined that 4,101 of these may be eligible for Innocent Spouse relief and we issued letters to each taxpayer inviting them to reapply.

### **NTA Status Update to Recommendation 4**

#### **NTA Recommendation 5**

5. Outreach and Education. When the IRS implements changes to the Innocent Spouse program, such as those recommended by the National Taxpayer Advocate, it should communicate such changes to taxpayers through targeted outreach and education efforts.

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### IRS Response to Recommendation 5

The Task Team is developing a tri-fold document explaining the new Form 8857.

### NTA Status Update to Recommendation 5

#### NTA Recommendation 6

6. Date Stamping Form 8857. Campus processing procedures for IRS employees who open mail should make clear that they need to date stamp Form 8857 upon receipt. These employees rely on IRM § 3.10.72, which includes a list of correspondence that requires a date stamp. This list does not include Form 8857. Specifically, the IRS should revise IRM § 3.10.72 so the appropriate employees are aware of the date stamping requirement.

### IRS Response to Recommendation 6

While the Advocate believes that some claims are not date stamped, leading to erroneous collection actions, our data indicates that 98.5 percent of all innocent spouse claims filed are received directly by CCISO. Of these claims, all are date stamped upon receipt and collection activity is stopped on the date received. In addition, they are currently screened within two business days. The remaining 1.5 percent are claims not initially received directly into CCISO and only a small percentage of these do not have original received date stamps. In these instances, CCISO examiners are instructed to determine the received date by looking at the envelope or any correspondence attached. Any collection action erroneously taken after the received date on this small population of claims is refunded to the taxpayer.

### NTA Status Update to Recommendation 6

#### NTA Recommendation 7

7. Reconsideration Process. The IRS should reconsider innocent spouse determinations when taxpayers provide new information, just as it reconsiders all other liability determinations pursuant to its audit reconsideration process when taxpayers provide new information. In its response, the IRS notes, “the statute does not permit the IRS to apply the same audit reconsideration procedures to innocent spouse claims as it uses for audit deficiency assessments.” The IRS may be focusing on the fact that the Code expressly authorizes the IRS to rescind a notice of deficiency with the taxpayer’s consent, but does not expressly authorize the IRS to rescind a final determination under the innocent spouse rules. To be clear, however, we do not suggest that the IRS should rescind a final determination, but rather that the IRS reconsider relief when appropriate after a final determination has been made. The Code does not prohibit such a procedure, and the IRS should implement it without delay.

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### **IRS Response to Recommendation 7**

The IRS reconsiders a determination if additional information is received after a denial letter is issued but prior to issuance of the final determination letter. Except in limited circumstances, the statute does not permit the IRS to apply the same audit reconsideration procedures to innocent spouse claims as it uses for audit deficiency assessments.

### **NTA Status Update to Recommendation 7**

### **NTA Recommendation 8**

8. Reconcile Inconsistent Computer Systems. The IRS should continue its initiative to reconcile the differences between ISTS and ACDS. Once it has good consistent cycle time data, management will be better able to detect the real source of any delays.

### **IRS Response to Recommendation 8**

There are several other initiatives underway to improve the Appeals Innocent Spouse program, particularly in reducing processing time, reporting of case resolution data, and resolving discrepancies between computer systems. This includes creating an automated closing document for innocent spouse cases to provide better reporting on case resolution and implementing an automated match of the Innocent Spouse Tracking System (ISTS) and Appeals Centralized Database System (ACDS).

The ISTS is a system that records all activity taken on an innocent spouse claim. Appeals is required to keep ISTS current. As noted in the MSP, it has been determined numerous Appeals cases were closed but were not updated on ISTS which contributed to the cycle time. We are currently in the process of updating ISTS to show the cases as closed. Any delays identified through ISTS by CCISO are forwarded to Appeals for resolution, with close coordination between the staffs of both organizations.

In addition to recording data on ISTS, Appeals maintains another database called the Appeals Centralized Database System (ACDS). ISTS and ACDS systems were designed for different purposes and each measures different outcomes. The differences between ACDS and ISTS do not hinder the IRS' ability to identify and address the source of any delays. A comparison of the data, as mentioned in the Advocate's report, is difficult because of the different methods of reporting. Not only is there a difference between ACDS cases (reporting taxpayer units) versus ISTS claims (reporting tax years), there are differences in the dates used to capture cycle time measures in each system.

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It is important to ensure the systems capture inventory and disposal information accurately and that each system contain accurate information about each case. Appeals and CCISO partnered to develop a methodology to reconcile and validate ACDS and ISTS data. During FY 2005, an automated program was developed to match ACDS and ISTS inventories. This will ensure the two systems account for all cases and they are all in the same status. Initial programming of ISTS/ACDS validation reports (reports that match ACDS to ISTS) was deployed to ACDS on February 16, 2005. Additionally, Appeals and CCISO jointly pursued an automated option to automatically make the updates between the two systems in order to save time and enable staff to redirect this time to resolving taxpayer issues. It has been determined that the systems can be made to interface with each other and a RIS will be prepared to start development.

### NTA Status Update to Recommendation 8

#### NTA Recommendation 9

9. Study Ways To Further Reduce Processing Time. The IRS should sponsor research to determine how it can reduce the time a given taxpayer has to wait for determinations by Compliance and/or Appeals. In researching this issue, the IRS should conduct interviews and focus groups with taxpayer representatives, including Low Income Taxpayer Clinics, as well as taxpayers, to determine what are the sources of delays and confusion from the perspective of taxpayers and their representatives.

#### IRS Response to Recommendation 9

As recognized in the Advocate's report, Appeals and Compliance functions continue to reduce innocent spouse processing times. The cycle time for an innocent spouse determination made by CCISO decreased from 232 days in Fiscal Year (FY) 2004 to 189 days in FY 2005. As of November 2005, determination letters were issued on requests from June 2005. Appeals restructured its operations to devote specialized resources to resolving innocent spouse cases quickly and accurately. There are now two campus operations working these issues. The centralization of the Appeals Innocent Spouse Operation resulted in a significant reduction in cycle time in FY 2005 to 246 days. As these operations mature, further improvements in Appeals cycle time is expected.

In March 2005, Appeals created a specialized field team to resolve the older innocent spouse inventory. As of November 2005, the team closed a backlog of 238 cases in Appeals field operations' inventory and moved another 137 cases into "final determination" status. The transition of this inventory from the field offices to the two centralized operations resulted in significant cycle time improvements. Closed cases from the field operations averaged 425 days versus 246 days open from the campus operations.

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In addition, Innocent Spouse and Appeals HQ conducted a program review of appealed Innocent Spouse claims to determine if Appeals made accurate and timely determinations. The review revealed that although Appeals was making correct determinations, the letters used by Appeals needed improvement. In June, 2006, a sub-team of the Form 8857 Task Team met to review and revise the Innocent Spouse Correspondence letters and the Appeals Innocent Spouse letters. The cross-functional team consisted of a team leader from The Office of Taxpayer Burden Reduction, a plain language contractor and team member analysts and managers from HQ Innocent Spouse, CCISO, TAS, Appeals and Forms and Publications. The team's efforts will result in improved letters for both CCISO and Appeals.

### NTA Status Update to Recommendation 9

#### 2005 ARC – MSP Topic #20

#### LIMITATIONS OF COLLECTION ACCOUNT DATABASES

##### Problem

The lack of access to full taxpayer account histories in one place makes it difficult for IRS contact employees to respond to taxpayers' questions or provide proper guidance on potential case resolutions. This inaccessibility often leads taxpayers to seek the assistance of the Taxpayer Advocate Service. The Desktop Integration (DI) system provides IRS employees with greater access to the information needed, but not all systems interface with DI and not all IRS employees are required to use DI. The National Taxpayer Advocate urges the IRS to expand the number of systems interfacing with DI as well as requiring all IRS contact employees to use DI.

##### NTA Recommendations

1. Make every effort to secure proper funding of the Universal Case History initiative and expedite the development and implementation of the system.
2. Expedite the enhancement of Desktop Integration (DI) to interface the Integrated Collection System (ICS) with DI to add history and extract information from Automated Levy System (ALS), Automated Offer in Compromise System (AOIC), Automated Insolvency System (AIS), and other systems.
3. Review whether customers would be best served if W&I CAS employees were required to use DI and complement such access through the use of other applications not programmed into the system.
4. Review the feasibility of interfacing the various Appeals systems with DI.
5. Integrate the systems to allow IDRS to provide sufficient details on cases appealed through CAP and on designated payment codes for installment agreements, defined seizures, and user fees.

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6. Make all efforts to fully implement the Customer Account Data Engine (CADE) in an expeditious manner.

### NTA Recommendations 1 and 2

1. Make every effort to secure proper funding of the Universal Case History initiative and expedite the development and implementation of the system.
2. Expedite the enhancement of Desktop Integration (DI) to interface the Integrated Collection System (ICS) with DI to add history and extract information from Automated Levy System (ALS), Automated Offer in Compromise System (AOIC), Automated Insolvency System (AIS), and other systems.

### IRS Response to Recommendations 1 and 2

The IRS is committed to improving customer service by creating a Universal Case History. We proposed and secured approval for the Universal Case History project as an IT improvement project for FY 2007 & FY2008.

The Universal Case History project would be accessed through a central point so when a taxpayer contacts the IRS about a collection issue, relevant account history is available to respond to the issue appropriately, while minimizing the need to access multiple systems. In the 2007/2008 Project, Desktop Integration (DI) will be enhanced to accept additional case history entries from other IRS systems such as Integrated Collection System (ICS)..

In 2006, Integrated Collection System (ICS) users will have access to DI and therefore will have access to case history input by ACS and the Campuses. The Universal Case History Project will also be enhanced extract information from the Automated Lien System (ALS), Automated Offer in Compromise System (AOIC), Automated Insolvency System (AIS) and other systems to secure account information and resolution codes. The project will leverage and enhance document imaging capabilities to associate documents, such as written correspondence, with the accounts.

### NTA Status Update to Recommendations 1 and 2

### NTA Recommendation 3

3. Review whether customers would be best served if W&I CAS employees were required to use DI and complement such access through the use of other applications not programmed into the system.

### IRS Response to Recommendation 3

The Wage and Investment Division's Customer Accounts Services (CAS) organization did not request to exempt its employees from the requirement to use DI. Rather, CAS management determined that, in order to best assist taxpayers,

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its employees needed to access a variety of applications that currently are not programmed into DI, such as CIS. CAS employees were notified that they are not required to use DI, although it is highly recommended, and that employees should use DI to complement work on the other systems and applications in instances where its use will improve efficiency. For example, DI will provide some automated forms, letters, and worksheets that are not available on CIS. Management's decision also allows employees to continue using the JEEDA/CASL tools (IDRS Automated Tools) to improve efficiency pending the integration into DI.

### NTA Status Update to Recommendation 3

#### NTA Recommendation 4

4. Review the feasibility of interfacing the various Appeals systems with DI.

#### IRS Response to Recommendation 4

Appeals employees use the Appeals Centralized Database System (ACDS) and up to 17 other IRS systems. The ACDS is Appeals' inventory system, but does not combine Appeals' standalone databases into one centralized system. Appeals has completed a "Concept of Operations" analysis and intends to create "interoperability" between the ACDS and the other approximately 17 systems, which will mean that, when Appeals closes a case with certain recommended actions, automatic or systemic changes to other databases, including IDRS, will be made. Further, Appeals employees will become users of DI during FY 2006. The interoperability study is largely completed for the Collection workstreams. A server was recently purchased by MITS that will facilitate Appeals' access to Desktop Integration (DI). Funds have been transferred from Appeals to W&I to program the interface. Note: It took longer than expected to reach this point because MITS could not purchase the server until they completed a study of the actual capacities of existing equipment. The rollout of DI in Appeals is expected to begin in calendar year 2007.

In July 2005, programming was completed to produce validation reports comparing CDPTS and ACDS to improve the consistency and reliability of data and inventory on both systems. Appeals and SBSE are using these reports cross-functionally and believe they will produce benefits for taxpayers. The programming was the first step of this project; the validation of the data is the second step. The validation process will be a multi-functional effort. The procedures for the validation are currently under discussion between Appeals and SB/SE.

Additionally, Appeals is developing better case resolution data to allow the Operating Divisions greater insight into how Appeals' employees resolve cases. The new procedure will allow Appeals to identify the number of cases denied in full or in part and the underlying reasons for resolution. The automated closing document will also contain instructions for the Appeals Processing Section to accurately and timely update all systems, including ACDS, ISTS and IDRS.

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Implementation of this new procedure should occur in FY 2006. The automated closing document is scheduled to become mandatory for use by Appeals employees on October 1, 2006.

### NTA Status Update to Recommendation 4

#### NTA Recommendation 5

5. Integrate the systems to allow IDRS to provide sufficient details on cases appealed through CAP and on designated payment codes for installment agreements, defined seizures, and user fees.

#### IRS Response to Recommendation 5

The IRS agrees with TAS' comment that IDRS currently does not have transaction codes to show the history of cases appealed through CAP, and IDRS users do not have information regarding the outcome of the past appeals or the status of current requests. This type of information would be useful in understanding taxpayer case resolution and history. As a result, Appeals will include this recommendation in our "interoperability" requirements mentioned earlier. Appeals employees are documenting their CAP case decisions in the ICS case history.

### NTA Status Update to Recommendation 5

#### NTA Recommendation 6

6. Make all efforts to fully implement the Customer Account Data Engine (CADE) in an expeditious manner.

#### IRS Response to Recommendation 6

The IRS currently is making every effort to implement CADE in an expeditious manner. As long as funding and release design capacity are available, the IRS will continue to move forward as rapidly as possible. Once the CADE/CAM Integrated Project Team revises Release 4 to include business (rather than taxpayer) priorities, the IRS should begin to see downstream benefits for operations such as Account Management (AM).

### NTA Status Update to Recommendation 6

## 2005 Annual Report to Congress: The Most Serious Problems Encountered By Taxpayers

### 2005 ARC – MSP Topic #21

#### REASONABLE CAUSE ASSISTANT

##### Problem

The IRS does not utilize the Reasonable Cause Assistant (RCA) program -- a computer-based decision support tool -- for all determinations of penalty abatements for reasonable cause. In addition, the high rate of RCA abatement conclusions indicates that the IRS needs to eliminate unnecessary penalty assessments. Because existing IRS data does not sufficiently differentiate RCA cases from non-RCA cases, the IRS cannot effectively analyze the penalty systems in place. The low rate at which RCA users abort the program's conclusions may indicate that RCA does not encourage users to override an RCA decision even when appropriate. The National Taxpayer Advocate urges the IRS to review RCA and all related training and guidance materials to determine whether the application actually gives the user the flexibility to fully consider unique facts and circumstances.

##### NTA Recommendations

1. Build on current efforts to reduce unnecessary penalty assessments by creating a cross-functional task force with representatives from the Taxpayer Advocate Service, the Office of Appeals, Management Information and Technology Service, W&I, SB/SE, and the Office of Penalty and Interest Administration. This group would identify the critical factors surrounding penalty assessments and abatements, the various systems used in making such determinations, and the structure for integrating the data between functions and taking corrective actions to minimize the burdens of the penalty process.
2. Test sending a "soft letter" with the actual tax assessment in instances where the IRS would normally assess a penalty, to inform the taxpayer that a penalty will be assessed within 30 days unless the taxpayer provides a reason to abate it. The letter could also include a form allowing the taxpayer to respond with reasons why the IRS should not assess the penalty. Information mailed with the letters could include the definition of reasonable cause and some of the categories and circumstances qualifying for abatement. The IRS could then follow up with the taxpayer for further discussion or substantiation where appropriate.
3. As RCA becomes more widely accessible to IRS employees through Desktop Integration, require the use of RCA after completion of adequate training by all personnel involved in reasonable cause abatement decisions. This requirement is critical to consistency in the abatement process.
4. Revise RCA to incorporate abatement determinations for Failure to Pay and Failure to File penalties for business taxpayers.
5. Review RCA and all related training and guidance materials to determine whether the application actually provides the user with the flexibility to fully consider unique facts and circumstances. The review should also include an analysis of

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penalty assessment and abatement data, a thorough examination of sample penalty abatement determinations, and a survey of RCA users.

6. Standardize the review and reporting of RCA data by OPI. OPI should report its findings to all RCA users and include basic communications about the effectiveness of the program as well as examples of common and unusual cases. RCA users can learn from the experiences of others, but they need a forum for receiving this information.
7. Build on current IRS efforts to educate users regarding the appropriate use of abort conclusions. The IRS should revise all RCA training materials and guidance to clearly state that aborting a conclusion, or taking the necessary extra time to address unusual facts and circumstances, will not negatively impact users' performance evaluations. The IRS should also seek input from both the Taxpayer Advocate Service and the Office of Appeals during the revision.

### **NTA Recommendation 1**

1. Build on current efforts to reduce unnecessary penalty assessments by creating a cross-functional task force with representatives from the Taxpayer Advocate Service, the Office of Appeals, Management Information and Technology Service, W&I, SB/SE, and the Office of Penalty and Interest Administration. This group would identify the critical factors surrounding penalty assessments and abatements, the various systems used in making such determinations, and the structure for integrating the data between functions and taking corrective actions to minimize the burdens of the penalty process.

### **IRS Response to Recommendation 1**

In 2004, a cross functional group studied the Systemic Assessment/Abatement of Failure to Deposit (FTD) Penalties. The IRS immediately implemented some actions to improve the process and implemented those requiring programming during the third quarter of Fiscal Year 2006. The IRS has not yet evaluated the impact of all actions. The Office of Penalties and Interest will evaluate the application and abatement process for certain penalties and determine if further action is warranted. Assistance from cross-functional representatives will be sought as needed.

### **NTA Status Update to Recommendation 1**

### **NTA Recommendation 2**

2. Test sending a "soft letter" with the actual tax assessment in instances where the IRS would normally assess a penalty, to inform the taxpayer that a penalty will be assessed within 30 days unless the taxpayer provides a reason to abate it. The letter could also include a form allowing the taxpayer to respond with reasons why the IRS should not assess the penalty. Information mailed with the letters could include the definition of reasonable cause and some of

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the categories and circumstances qualifying for abatement. The IRS could then follow up with the taxpayer for further discussion or substantiation where appropriate.

### **IRS Response to Recommendation 2**

This recommendation does not address the substance of the RCA program, but rather whether delayed assessment of a penalty for late filing or late paying will alter taxpayer behavior. RCA is the program used to determine whether penalty relief is justified.

Further, sending a definition of Reasonable Cause and examples of what constitutes reasonable cause could discourage some taxpayers from requesting relief if their particular reason is not shown. Other taxpayers may “find” a reason using those shown, which will not address the true reason for non-compliance.

### **NTA Status Update to Recommendation 2**

#### **NTA Recommendation 3**

3. As RCA becomes more widely accessible to IRS employees through Desktop Integration, require the use of RCA after completion of adequate training by all personnel involved in reasonable cause abatement decisions. This requirement is critical to consistency in the abatement process.

### **IRS Response to Recommendation 3**

IRM 20.1.1 requires the use of RCA where the program is available. The RCA program can only be accessed through Desktop Integration (DI), just as it previously was only available on Integrated Case Processing (ICP). During the transition to DI, SERP Alerts were issued relating to the use of RCA through DI and the requirement to use it. Because all Operating Divisions, or groups within certain Operating Divisions, do not use DI, RCA isn't available for all employees. Those employees profiled by their management to use RCA via DI are required to use the program.

### **NTA Status Update to Recommendation 3**

#### **NTA Recommendation 4**

4. Revise RCA to incorporate abatement determinations for Failure to Pay and Failure to File penalties for business taxpayers.

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### **IRS Response to Recommendation 4**

Expanding availability to BMF accounts is planned as the next phase of RCA. Its implementation was delayed due to staffing limitations and other priorities.

### **NTA Status Update to Recommendation 4**

#### **NTA Recommendation 5**

5. Review RCA and all related training and guidance materials to determine whether the application actually provides the user with the flexibility to fully consider unique facts and circumstances. The review should also include an analysis of penalty assessment and abatement data, a thorough examination of sample penalty abatement determinations, and a survey of RCA users.

### **IRS Response to Recommendation 5**

RCA incorporates the provisions for granting reasonable cause outlined in Policy Statement P-2-7, which are specific, and RCA provides abatement conclusions if reasonable cause is established. RCA also includes a category titled 'Other', which is available for evaluating facts and circumstances that do not fit into other categories. Unique facts and circumstances may establish reasonable cause if a taxpayer can demonstrate a sound reason why he or she was unable to comply.

RCA also includes a 'guided selection' feature that assists users in selecting the correct relief categories. While RCA does not, and cannot, provide for every reason taxpayers use in requesting penalty abatement, taxpayers generally request penalty abatement (outside of the specific reasonable cause provisions in P-2-7) based on facts that may seem reasonable but do not show the exercise of ordinary business care and prudence with regard to their tax obligations.

### **NTA Status Update to Recommendation 5**

#### **NTA Recommendation 6**

6. Standardize the review and reporting of RCA data by OPI. OPI should report its findings to all RCA users and include basic communications about the effectiveness of the program as well as examples of common and unusual cases. RCA users can learn from the experiences of others, but they need a forum for receiving this information.

### **IRS Response to Recommendation 6**

OPI plans to create an RCA page on its website, which may include data from RCA reports, that users could review.

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### NTA Status Update to Recommendation 6

#### NTA Recommendation 7

7. Build on current IRS efforts to educate users regarding the appropriate use of abort conclusions. The IRS should revise all RCA training materials and guidance to clearly state that aborting a conclusion, or taking the necessary extra time to address unusual facts and circumstances, will not negatively impact users' performance evaluations. The IRS should also seek input from both the Taxpayer Advocate Service and the Office of Appeals during the revision.

#### IRS Response to Recommendation 7

The RCA program enhances consistency of taxpayer treatment by limiting the situations in which IRS employees use their own discretion to determine penalty relief. As discussed above, IRS employees still have the ability to deviate from RCA's conclusions. The training course for the ICP version of RCA discouraged the use of the Abort option because it decreases the consistency the IRS seeks to enhance through RCA. The revised training material for the DI version has been reworded to neither encourage nor discourage the use of Abort. It simply states the Abort option is available if there are circumstances that could not be considered by RCA and the user can substantiate aborting RCA's decision. This is no different than the need to substantiate abating a penalty without using RCA. The new DI training material contains a statement that Abort conclusions will generate a report to OPI, but the key point the materials make is that the user must specify in the text the reason for aborting the conclusion (so an employee does not simply state "I disagree") and must substantiate why the user is aborting RCA's decision. This is the standard requirement to substantiate abating a penalty.

### NTA Status Update to Recommendation 7

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### 2005 ARC – KLR

#### ANOTHER MARRIAGE PENALTY: TAXING THE WRONG SPOUSE

##### Problem

The federal income tax liabilities of married persons are often imposed on or collected from a spouse who did not earn the income subject to tax, *i.e.*, the “wrong” spouse. Current law provides some relief to a spouse held liable for tax on the other spouse’s income, at least in cases where the first spouse did not know about the income and did not significantly benefit from it. However, the relief rules are sometimes overly narrow, complex, costly for the IRS to administer, and burdensome for taxpayers. Even if relief rules apply so that one spouse is not liable for his or her spouse’s tax, the IRS may be able to *collect* the liability from the non-liable spouse in community property states. We recommend that Congress amend the law to tax the “right” spouse in the first instance and to prevent the IRS from undermining this rule through its collection efforts. Our recommendation would better align each person’s tax with his or her individual ability to pay, significantly reduce complexity, and minimize the impact of state property and collection laws that subject taxpayers to different amounts of federal income tax solely because they reside in different states.

##### NTA Recommendations

1. Eliminate joint and several liability for joint filers. Require married taxpayers to file a split-column tax return which identifies separate items of income, deduction, credit, and payment, similar to the combined return adopted by a number of states.
2. Repeal the rule of *Poe v. Seaborn* that each spouse is taxed on one-half of any community income. Apply the federal rules for allocating a nonresident alien’s community income to all couples, with slight modification.
3. Require the IRS to exhaust efforts to collect against assets under the liable spouse’s control before collecting against assets under the nonliable spouse’s control, unless such efforts would be futile.

##### NTA Recommendation 1

1. Eliminate joint and several liability for joint filers. Require married taxpayers to file a split-column tax return which identifies separate items of income, deduction, credit, and payment, similar to the combined return adopted by a number of states.

##### IRS Response to Recommendation 1

Our response is limited to administrative concerns as any policy concerns would fall under the jurisdiction of the Treasury Department.

Adopting this change would be very costly to the government, private sector accountants and tax software companies.

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The government expenses would include but are not limited to the following:

- Computer re-programming for the following systems: Integrated Submission and Remittance Processing, Automated Underreporter, Automated Collection System, Master File, CADE and the Report Generated System (RGS) used by auditors.
- Cost of developing the new Form 1040, training material, and changing Internal Revenue Manuals.
- Training of all employees on how to complete and audit the new 1040.

The National Taxpayer Advocate's (NTA) report states "these administrative challenges have significantly declined since 1998 with the implementation of CADE." However, CADE now only processes Forms 1040EZ. CADE would require significant reprogramming.

IRS employees who work with taxpayers daily would need to be trained on the new form. This would include tens of thousands of Customer Service Representatives, Tax Accounting Officers, Revenue Officers, Revenue Agents, Appeals Officers, and those who are behind the scenes working with the account modules in Submission Processing and Accounts Management. There would also be a major impact on return preparation businesses that would need retraining and on tax preparation software companies that would need to make major changes to the programs that support e-file.

The NTA's report also states the IRS's administrative challenges could also be partially offset by the reduction in, or elimination of, innocent spouse relief, community property relief, injured spouse relief, and numerous Internal Revenue Code provisions that override community property rules in an ad hoc fashion. An average of the last five years shows only 26,358 taxpayers per year file for innocent spouse relief. In FY 2003, there were 51,472,672

taxpayers who filed a joint return. Joint filers in FY 2003 make up 38.5 percent of the total population while only .05 percent filed for innocent spouse relief. It would seem an unfair burden on the vast majority of the population to require this change for .05 percent of the taxpayers. In addition, the costs appear to outweigh the benefits for such a small population.

### **NTA Status Update to Recommendation 1**

### **NTA Recommendation 2**

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2. Repeal the rule of *Poe v. Seaborn* that each spouse is taxed on one-half of any community income. Apply the federal rules for allocating a nonresident alien's community income to all couples, with slight modification.

### IRS Response to Recommendation 2

We note that the proposal has far reaching policy implications throughout the Internal Revenue Code that would have to be resolved at the Treasury Department and Congressional levels.

By enacting a statute modifying a 1930's-era Supreme Court case relating to community property and the allocation of income, the IRS would have to change its procedures and processes for all individuals who file returns as married, filing separately. As noted above, administrative concerns include the cost of modifications that would have to be made to multiple IRS forms and publications, training for tens of thousands of employees, and major changes in our processing systems.

### NTA Status Update to Recommendation 2

### NTA Recommendation 3

3. Require the IRS to exhaust efforts to collect against assets under the liable spouse's control before collecting against assets under the nonliable spouse's control, unless such efforts would be futile.

### IRS Response to Recommendation 3

When a joint return is filed, both spouses are jointly but separately liable for all taxes, penalties, and interest. Therefore, the IRS can collect against assets of both spouses. If, after the joint return has been filed, one spouse files for relief of the joint liability through an offer-in-compromise, bankruptcy, or IRC § 6015 and relief has been granted to the requesting spouse, that spouse is no longer liable. The joint liability then becomes the sole liability of the non-requesting spouse. The IRS stops collection activity against the spouse that was granted relief from joint liability under these procedures. In addition, the IRS generally suspends collection actions against a requesting spouse until their request for relief has been resolved.

When taxpayers choose to file a married filing separate (MFS) return and they live in a community property state, they are taxed at 50 percent of their income and 50 percent of their spouses' income. Therefore, ½ of their liability is reported under their spouse's social security number (SSN) and ½ under their own. One taxpayer can full pay their liability and still be responsible for the other spouse's liability according to the Internal Revenue Code and most state tax laws. The Master File is programmed to look for possible refund offsets when balance due MFS returns are filed. Because MFS

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returns list the other spouse's SSN, the computer will offset refunds to collect either spouse's underpayment. Since the majority of these balances due do not meet criteria for being worked by a Revenue Officer in the field, the government's best source of payment are refund offsets. To implement the TAS recommendation would require significant and costly reprogramming and changes to currently effective procedures for collecting community property state MFS underpayments.

### **NTA Status Update to Recommendation 3**